

〈논문〉

China's Practice in International Investment Law*

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Abstract

China is now the largest recipient of foreign direct investment among emerging markets and a major home country for FDIs. In less than 40 years since it began its modernization process in the late 1970s, the country has entered into more than 120 bilateral investment treaties (BIT) and free trade agreements (FTA). With the status change from a pure capital importing country to a country of both importing and exporting capital, China's policy toward foreign investment has evolved from emphasizing the rights of home States to focusing on protection of investors and investments. An example in this regard is investor-state arbitration which was strongly resisted by China but now a common feature in all BITs and FTAs to which China is a party. This article first examines China's practice toward foreign investment over the last three decades and more, analyzing China's policy reflection on treaties and laws. The mechanisms that China has established in respect of foreign investment are discussed. Thereafter, detailed comparison and discussions are made between China's treaty practice and international investment arbitration to illustrate in what way and to what extent China's practice is in compliance with contemporary investment arbitration practice. Issues analyzed include, qualified investors and investments, fair and equitable treatment, minimum standard of treatment, full protection and security, most-favoured-nation treatment,

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national treatment, expropriation and compensation, and mechanisms relating to dispute resolution.

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China started its long march for modernization in 1978 by encouraging the inflow of foreign capital and technology and reforming the domestic economy.¹⁾ In a short span of 30 years, it is now the most active and largest developing host country for foreign direct investment,²⁾ which has been resulted from its economic reforms and opening to the outside world in the last three decades, Over the last 30 years, China entered into more than 120 bilateral investment treaties (BIT)³⁾ and several Free Trade Agreements. In April 2008, had China not only enter into a Free Trade Agreement (“FTA”) with New Zealand which marked the first FTA that it has signed with a developed country,⁴⁾ but also started negotiations on BIT

1) After the death of late Chairman Mao Zedong in 1976, Deng Xiaoping came into power. The Chinese Communist Party held its 3rd Plenary Session of the 11th Central Committee meeting which declared that the country would end the notorious Cultural Revolution and abandon large scale political movement. It also announced that the country would embark on domestic economic reforms and open to the outside world. For more detailed discussions, see Guiguo Wang, *Wang's Business Law of China* (4th Ed), LexisNexis Butterworths, 2003, Chapter 2.

2) According to the statistics issued by the Ministry of Commerce of the People's Republic of China, China absorbed US\$747.1 billion foreign investment by the end of 2007. See http://www.fdi.com.cn/pub/FDI_EN/News/Focus/Subject/Utilization2007/default.html. According to 2007 World Investment Report of UNCTAD, China ranked No.5 globally and No.1 among developing countries in direct foreign investment inflow. It continued to be regarded as the most attractive host country and first R&D choice worldwide. For details, see <http://www.unctad.org/Templates/Page.asp?intItemID=1465>.

3) See UNCTAD, “Recent Developments in International Investment Agreements:2007-June 2008”, p. 3, figure 2, available at http://www.unctad.org/en/docs/webdiaeia20081_en.pdf.

4) China and New Zealand started to carry out a feasibility study for concluding a FTA.

with the United States - its most important trading partner.⁵⁾ As China is now one of the fastest growing economies in the world,⁶⁾ it has also re-negotiated its BITs with other countries, which demonstrates the country's willingness to accept the modern standards of treatment to foreign investments.

As the second-largest FDI recipient (after the United States), attracting around US\$ 95 billion in 2009, according to the World Investment Report 2010,⁷⁾ China is almost immune from investor-state arbitration, either as investor or host state.⁸⁾

The two countries signed a FTA on April 7, 2008. By 2008, China was the fourth largest trading partner of New Zealand, importing over \$1.6 billion of New Zealand's merchandise and over \$1 billion of services per annum. It was also anticipated that China's middle class which was estimated to be more than 100 million people would also increase the import by China of New Zealand's agricultural products. For details, see <http://www.mfat.govt.nz/Trade-and-Economic-Relations/Trade-Agreements/China/index.php>.

- ⁵⁾ The United States announced that after 17 month preliminary negotiations with China, both countries had agreed to start negotiations for a bilateral investment treaty ("BIT") on June 20, 2008. Bureau of Economic, Energy and Business Affairs of the Department of State announced that the negotiations would cover the following aspects: (1) non-discriminatory treatment; (2) fair and equitable treatment, including the right to due process; (3) compensation in the event of expropriation or nationalization; (4) free transfers of capital; (5) transparent regulation; and (6) submitting disputes to independent international arbitration. It also considered that the BIT would, if successfully negotiated and entered into, "require China to abide by clear, certain and agreed rules on investor protection and transparency of investment-related laws and regulations". See <http://www.state.gov/e/eeb/rls/fs/2008/106132.htm>.
- ⁶⁾ The average annual GDP growth rate of the Asia and Pacific region during the period of 1990 to 2006 was 5.7% which was the highest compared to other regions of the world. Within the Asia-Pacific region, China has been in leading position in economic development. Its average annual GDP growth rate between 1990 to 2006 was 10.2%. See UNESCAP, *Statistical Yearbook for Asia and the Pacific 2007*, available at www.unescap.org/stat/data/syb2007/ESCAP-SYB2007.pdf.
- ⁷⁾ See UNCTAD, *World Investment Report 2010: Investing in a Low Carbon Economy*, p. 4; available at: http://www.unctad.org/en/docs/wir2010ch1_en.pdf.
- ⁸⁾ Regarding investor-State disputes under China-related BITs, *Tza Yap Shum v. Peru* is the only case. See *Tza Yap Shum v. Republic of Peru*, ICSID Case No. ARB/07/6, registered 12 February 2007, award issued 7 July 2011 (not yet published). On 24 May 2011, a Malaysian company filed the first-ever case against the Chinese government before ICSID, but that case was "suspended" on 12 July 2011 "pursuant to the parties' agreement". See *Ekran Berhad v. People's Republic of China*, ICSID Case No. ARB/11/15; status available via the ICSID website at: <http://icsid.worldbank.org/ICSID/>

The above having been said, recent Chinese practice will have important consequences on its laws and legal systems. Recognition of investment interests of legal persons established by nationals of a BIT contracting party in a third country is an example. In the past, China refused to protect such investment; yet the China-Argentina BIT (1992) and China-Brunei BIT (2000) offer protections to such investment.⁹⁾ China is an important recipient of FDI, at the same time its role as a capital exporting country is also growing.¹⁰⁾ Any policy taken by China through signing BIT or FTA will have an international implication.

I. Mechanisms for Protecting Foreign Investment

For the purpose of attracting foreign investment, China adopted the Chinese-Foreign Joint Venture Law in 1979.¹¹⁾ Almost 10 years later, the Chinese-Foreign Cooperative Venture Law¹²⁾ was enacted to be followed by the Wholly Foreign-owned Enterprise Law.¹³⁾

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- ⁹⁾ Article 2 of the 1992 China-Argentina BIT reads “If natural or judicial persons of a Contracting Party have an interest in a judicial person which was established within the territory of a third State, and this judicial person invests in the Other Contracting Party, it shall be recognized as a judicial person of the former Contracting Party.”
- ¹⁰⁾ For instance, 1067 medium- and large-sized Chinese enterprises made investment overseas in 2005, the agreed investment value of the Chinese parties amounted to US\$6.954bln. See <http://english.mofcom.gov.cn/aarticle/statistic/foreigninvestment/html>.
- ¹¹⁾ Law of the People’s Republic of China on Chinese-Foreign Equity Joint Ventures adopted on July 1, 1979 at the Second Session of the Fifth National People’s Congress, and amended by the 4th Session of the Standing Committee of the 9th National People’s Congress on March 15, 2000 (hereinafter “Chinese-Foreign Joint Venture Law”).
- ¹²⁾ Law of the People’s Republic of China on Chinese-Foreign Contractual Joint Ventures adopted at the First Session of the Seventh National People’s Congress and promulgated by Order No. 4 of the President of the People’s Republic of China on April 13, 1988, and effective as of the date of promulgation.
- ¹³⁾ Law of the People’s Republic of China on Wholly Foreign-Owned Enterprises adopted on April 12, 1986 by the 4th Session of the 6th National People’s Congress and amended on October 31, 2000 by the Standing Committee of the 18th Session of the

These three laws dictated the forms of foreign investment in China.¹⁴⁾ In general, there was no upper limit for foreign equity holding. Yet it is stipulated that foreign investors' ownership must not be less than 25% of the total investment.¹⁵⁾ As to the sectors for investment, there have always been restrictions.¹⁶⁾ After China joined the WTO, some service sectors are open to foreign investors.¹⁷⁾

A very important issue in China's effort to attract foreign investment was treatment of foreign investors, in particular, whether foreign investment might be expropriated and if so, whether compensation would be paid and the standard for assessing foreign investment assets.¹⁸⁾ These questions arose because the Chinese government nationalized foreign and Chinese private concerns after its establishment

9th National People's Congress.

- ¹⁴⁾ According to the statistics issued by the Ministry of Commerce of the People's Republic of China, by the end of 2005, more than 630,000 FDIs had been established. See: http://www.fdi.com.cn/pub/FDI_EN/News/Focus/Subject/Utilization2007/default.html. All these enterprises were established in accordance with the Chinese-Foreign Joint Venture Law, Chinese-Foreign Cooperative Venture Law and Wholly Foreign-owned Enterprises. In practice, many Chinese entities still prefer equity joint ventures when cooperating with foreign counterparts.
- ¹⁵⁾ Article 4 of the Chinese-Foreign Joint Venture Law provides : "The proportion of the foreign party's contribution to the registered capital of an equity joint venture shall in general not be less than 25 percent."
- ¹⁶⁾ The control exercised by the Chinese government is through approval process of the equity ventures. According to Article 3 of the Chinese-Foreign Joint Venture Law, the agreement, contract and articles of association of an equity joint venture signed by the Chinese and foreign parties must be submitted to the state department in charge "for examination and approval." The Chinese government also publishes foreign investment guidelines stipulating the areas that are restricted from and those are encouraged to attract foreign investments. For details, see www.mofcom.gov.cn.
- ¹⁷⁾ For details, see Protocol on the Accession of the People's Republic of China and Report of the Working Party on the Accession of the People's Republic of China adopted at the Doha Ministerial Conference on November 10,2001 (WT/ACC/CHN/49). For discussion on the matter, see Guiguo Wang, *The Law of the WTO China and the Future of Free Trade*, Sweet & Maxwell, Asia, 2005.
- ¹⁸⁾ These are still paramount issues for foreign investors although the form and scale of expropriation have changed over time. Open nationalization or expropriation is no longer the issue but regulatory taking has become a concern of the contemporary world. This is evidenced in the ICSID arbitration relating to Argentina, Mexico, etc.

in 1949.¹⁹⁾ Also since China assumed the seat at the United Nations, it had always followed the policies of developing countries in respect of south-south and north-south issues.²⁰⁾

At first, the Chinese government tried to ease the concern of foreign investors over expropriation through domestic laws.²¹⁾ For instance, Article 2 of the Chinese-Foreign Joint Venture Law provides: “The State shall not nationalize or requisition any joint ventures. Under special circumstances, in the interest of the public, the State may requisition a joint venture in accordance with legal procedures and appropriate compensation shall be made.”²²⁾ It should be pointed out however

¹⁹⁾ After the establishment of the People’s Republic in 1949, China expropriated all the private enterprises, which process was essentially completed by 1957 when the country started the Anti-Rightists Movement. For discussion on China’s political and economic situation in particular expropriation, see George N. Ecklund, “Protracted Expropriation of Private Business in Communist China”, *Pacific Affairs*, Vol. 36, No. 3 (Autumn, 1963), pp. 238-249.

²⁰⁾ At the Sixth Special Session of the UN General Assembly in 1974, Deng Xiaoping, then Vice Premier of China expounded the theory of three worlds and stressed the need for establishing a new international economic order. Soon after assuming its seat in the UN, China joined the Group of 77 known as “the G77 plus China”. China shared views of developing countries in and contributed to the adoption of the 1974 Charter of Economic Rights and Duties of States, the 1990 Declaration on International Economic Co-operation, in particular the Revitalization of Economic Growth and Development of the Developing Countries, etc. For more on China’s role these issues, see <http://www.showchina.org/zgygjzzxl/zgylhg/04/200701/t107115.htm>.

²¹⁾ Some scholars argued that the concern about macro political risks such as expropriation missed the zeitgeist of post-Mao China and that as part of its commitment to reform, China had paid less attention to its theoretical right to seize foreign assets and the ensuing legal implications than to its ability to attract foreign investment. See David L. Weller, “The Bureaucratic Heavy Hand in China: Legal Means for Foreign Investors to Challenge Agency Action”, *Columbia Law Review*. Vol. 98, No. 5 (June 1998), p. 1238.

²²⁾ At the same time, Article 5 of the Wholly Foreign-owned Enterprise Law states that the state shall not nationalize or requisition any foreign-owned enterprises. Under special circumstances, however, where public interest requires, foreign-owned enterprises may be requisitioned through legal procedures and appropriate compensation shall be made, the same Article provides. Article 5 of the Regulations of the People’s Republic of China on Sino-foreign Cooperation in the Exploitation of Continental Petroleum Resources prescribes that the State shall not expropriate the investments and income of foreign

that when China started its policy on domestic reforms and opening to the outside world 30 years ago, concerns relating to expropriation of foreign investment were quite different from those in the 21st century.²³⁾ Even taking that into account, the Chinese law provisions could not ease the concern of foreign investors, as at that time the rest of the world and China were mutually unknown to each other. For instance, expropriation for public purposes had already been commonly accepted by Western countries, when the Chinese-Foreign Joint Venture Law was adopted. Yet, Chinese scholars were still debating whether nationalization was an exercise of sovereignty and if yes, what should be the standard of compensation.²⁴⁾ Regarding the standard for compensation, China took the developing countries' view, i.e., appropriate compensation, which begged more rather than solved questions.²⁵⁾

enterprises that participate in the cooperative exploitation of continental petroleum resources and that under special circumstances, the State may, according to the needs of public interests, expropriate a portion or all of the petroleum due to foreign enterprises in connection with their cooperative contracts.

- ²³⁾ Currently the international community pays more and more attention to creeping expropriation or indirect expropriation. As a result, changes in exchange rates, repatriation policies, adoption and amendment of laws relating to taxes, prices, labor, import and export, foreign control of certain types of companies, etc. may all lead to disputes involving creeping expropriation. A renegotiated contract may also result in suspension of indirect expropriation if the terms thereof become less favorable to the foreign investors in question. For discussions on the issues relating to China, see Pat K. Chew, "Political Risks and U.S. Investment in China : Chimera of Protection and Predictability?" *Virginia Journal of International Law*, Vol. 34 (1994), p. 615. Timothy A. Steinert, "If the BIT Fits: The Proposed Bilateral Investment Treaty between the United States and the People's Republic of China," *Journal of Chinese Law*, Vol. 2 (Fall 1988), p. 451. Even Chinese scholars have admitted that indirect expropriation is not an impossibility in China. See Zeng Huaqun, *WTO and the Development of Foreign Investment Law of China*, Xiamen University Press, 2006, p. 290.
- ²⁴⁾ See Wang Xuan, "Permanent Sovereignty of States toward Natural Resources", *Chinese Yearbook of International Law* (1982), pp. 99-114; Mei Ruao, "Legal Protection of International Investment", *Chinese Yearbook of International Law* (1982), pp. 115-144; Ni Zhengyu, "Theory and Practice of State Immunity", *Chinese Yearbook of International Law* (1983), pp. 3-30; and Chen Tiqiang, "State Sovereign Immunity and International Law", *Chinese Yearbook of International Law* (1983), pp. 31-53.
- ²⁵⁾ It is interesting to note that in his separate opinion in *CME Czech Republic B. V. v. Czech Republic*, UNCITRAL which was issued in 2003, Professor Ian Brownlie suggested,

In addition to the issues relating to expropriation, there were other hurdles in Chinese law on foreign investment, including Chinese law being the governing law on foreign investment contracts,²⁶⁾ although investment disputes among contracting parties may be resolved within or outside China.²⁷⁾ No right relating to investor-state arbitration was stipulated in Chinese law.²⁸⁾

Naturally what the Chinese government did was welcomed by foreign investors who at the same time expected China to adopt more measures in protecting their interests.²⁹⁾ For instance, the Joint Venture Law only mentioned compensation for nationalization but without specifying what were the related rights and interests of joint ventures. Also, what forms of investment other than the joint ventures that would be considered as foreign direct investment and would therefore be entitled to the same treatment in case of nationalization were not stipulated in detail either.³⁰⁾

by relying on 1974 UN General Assembly Resolutions, appropriate compensation as the standard in assessing Czech Republic's liability.

²⁶⁾ Article 2 of the Chinese-Foreign Joint Venture Law which stipulates that joint venture agreements, contracts and articles of association are subject to relevant Chinese laws.

²⁷⁾ Article 15 of the Chinese-Foreign Joint Venture Law provides that parties to Chinese-foreign joint ventures may, by agreement, have their disputes resolved by a Chinese arbitration body or another arbitration body, which is interpreted to mean a foreign arbitration body, and that where there is no agreement on arbitration, a disputing party may bring the case to a Chinese court. In practice, most Chinese-foreign joint venture contracts contain provisions for settling disputes by arbitration tribunals within China in particular by China International Economic and Trade Arbitration Commission.

²⁸⁾ Having recognized the limits of traditional remedies available to foreign investors against host countries, such as local court proceedings and diplomatic protection, the World Bank started to create a special mechanism for resolving investor-state disputes in 1961. In 1965, the Executive Directors of the World Bank adopted the text of the Convention on the Settlement of Investment Disputes between States and Nationals of Other States which entered into force in 1966 after the depositing of 20 ratifications. For more on the Convention, see P.F. Sutherland, "The World Bank Convention on the Settlement of Investment Disputes", *International and Comparative Law Quarterly*, Vol. 28, (July 1979), pp. 367-400.

²⁹⁾ See Stanley Lubman, "Looking for Law in China", *Columbia Journal of Asian Law*, Vol. 20, No. 1, (Fall 2006), pp. 1-92. Jerome Alan Cohen and Stuart J. Valentine, "Foreign Direct Investment in the People's Republic of China: Progress, Problems and Proposals", *Journal of Chinese Law*, Vol. 1, (Fall 1987), pp. 161-200.

³⁰⁾ There are differences under the Chinese Constitution with regard to protection against

Unless these questions were answered, the skeleton type Chinese laws mentioned above may be of little use to foreign investors.³¹⁾ The solution of the problem rested on the formation of international mechanisms for the protection of foreign direct investment in China.

The first step that China took for creating an international mechanisms in absorbing foreign direct investment was conclusion of bilateral investment treaties (BITs).³²⁾ The first group of BITs that China entered into was with Germany (1983),³³⁾ France (1984)³⁴⁾ and Norway (1984).³⁵⁾

All these BITs have a common feature of being brief in nature. For instance, the China-Norway BIT has only 9 articles which outlined the desire of both parties in promoting bilateral investment and a few concepts such as investment

expropriation to foreign-owned properties as opposed to domestic-owned private properties. See Yasheng Huang, "One Country, Two Systems : Foreign-Invested Enterprises and Domestic Firms in China", *China Economic Review*, Vol. 14 (2003), pp. 404-416.

³¹⁾ As a practice in the 1980s and 1990s, where a law was adopted by the National People's Congress, implementation provisions would be enacted by the State Council; further details rules may also be promulgated by the ministries in charge under the State Council. Even so, Chinese laws adopted in those years were quite brief compared with those in the United States and other developed countries. For a detailed account on China's law making, see Guiguo Wang, *Wang's Business Law of China, supra*.

³²⁾ At that time, lawyers and scholars from the United States and elsewhere often advised the Chinese government on foreign investment issues, although such advice was given unofficially. The Chinese government also sent their officials as visiting scholars to foreign countries to study. At least three heads of the Law and Treaties Department of the Ministry of Foreign Trade and Economic Cooperation, predecessor of the Ministry of Commerce of China, studied in the United States. Such exchanges helped China understand the need of foreign investors greatly. Therefore to use BIT as a means for promoting foreign investment was not unthinkable for the Chinese government.

³³⁾ Agreement between the People's Republic of China and the Federal Republic of Germany on the Encouragement and Reciprocal Protection of Investments (1983).

³⁴⁾ Agreement between the Government of the People's Republic of China and the Government of the French Republic on the Reciprocal Encouragement and Protection of Investments (1984).

³⁵⁾ Agreement between the Government of the People's Republic of China and the Government of the Kingdom of Norway on the Mutual Protection of Investments (1984). See http://www.unctad.org/sections/dite/ia/docs/bits/china_norway.pdf.

and investors. It emphasizes on the right of subrogation in case of expropriation and repatriation of investment. The MFN (MFN) treatment is stipulated but not national treatment.

Improvement was made after China gained some experience of foreign investment treaties and became more familiar with the international practice. An example is the China-UK BIT entered into in 1986,³⁶⁾ in which the Hull Rule for compensation for expropriation was accepted. The contents of thereof were also more detailed.

With the help of the above laws and BITs, China achieved good results in attracting foreign investment in the 1980s.³⁷⁾ In 1992 late Chinese leader Deng Xiaoping took a tour to the southern part of China to advocate further reform.³⁸⁾ Thereafter, the Chinese government formally announced that it would gradually adopt the market economy with Chinese characteristics, which triggered another wave of inflow of foreign investment.³⁹⁾

The surge of foreign capital and technology inflow led to a new stage of participation

³⁶⁾ Agreement between the Government of the United Kingdom and North Ireland and the Government of the People's Republic of China concerning the Promotion and Reciprocal Protection of Investments, available at: http://www.unctad.org/sections/dite/ia/docs/bits/uk_china.pdf. China and Britain signed a Joint Declaration on the Question of Hong Kong in 1984, per which Britain agreed to return Hong Kong to China by 1997 and China agreed to maintain the capitalist system of Hong Kong thereafter for 50 years. That was considered by China as a friendly move. Therefore it was understandable that China was prepared to make more cessions in its BIT with Britain than with others.

³⁷⁾ China signed 19 BITs in 1980s which made it an attractive recipient for foreign investment.

³⁸⁾ After the Tiananmen movement of "June 4", 1989, foreign countries imposed economic sanctions on China. Within the country and among the leadership, there were doubts as to whether further opening of the country would be in its best interest. Deng Xiaoping, whilst without official position, followed the steps of late Chairman Mao Zedong, toured the more liberal minded southern part of China and used his personal influence to call upon the leadership for further reform.

³⁹⁾ Article 15 of the Constitution reads: "The State practices planned economy on the basis of socialist public ownership. It ensures the proportionate and coordinated growth of the national economy through overall balancing by economic planning and the supplementary role of regulation by the market", the 1993 Amendment to the Constitution changed "planned economy" into "socialist market economy."

by China in international mechanisms. It became a contracting state of the ICSID Convention on 6 February 1993,⁴⁰⁾ although it was considered a small step in ensuring protection of foreign investors as China made a reservation that it “would only consider submitting to the jurisdiction of ICSID disputes over compensation resulting from expropriation or nationalization”.⁴¹⁾ Thereafter China accelerated the process of concluding new BITs and amending the existing ones. The most recently re-negotiated BITs include China-Germany (December 2003),⁴²⁾ China-Finland (November 2004),⁴³⁾ China-Spain (November 2005)⁴⁴⁾ and China-Portugal (December 2005).⁴⁵⁾

These newly revised BITs represent China's current position on international investment law. They constitute a new generation of BITs with China's participation. Significant changes that have been built into these BITs include definition of investment and investors, treatment of foreign investment, expropriation and compensation and dispute settlement in particular investor-state arbitration, etc.

The FTAs to which China is a party also constitute the Chinese mechanisms

⁴⁰⁾ China signed the ICSID Convention on February 9, 1990, deposited its ratification on January 7, 1993 and became a member state on February 6, 1993. As for China's reservation, see ICSID official document No. ICSID 8-D.

⁴¹⁾ The reservation made by China was considered by some as reluctance to accede to international arbitration. Mark A. Cymrot, “Investment Disputes with China”, *Dispute Resolution Journal*, Aug-Oct, 2006, http://findarticles.com/p/articles/mi_qa3923/is_200608/ai_n16779631.

⁴²⁾ The Agreement between the People's Republic of China and the Federal Republic of Germany on the Encouragement and Reciprocal Protection of Investments was signed on December 1, 2003 and entered into force on November 11, 2005, http://www.unctad.org/sections/dite/ia/docs/bits/china_germany.pdf.

⁴³⁾ The Agreement between the Government of the Republic of Finland and the Government of the People's Republic of China on the Encouragement and Reciprocal Protection of Investments was signed on November 15, 2004 and entered into force on November 15, 2006.

⁴⁴⁾ The Agreement between the People's Republic of China and the Spanish Kingdom on the Encouragement and Reciprocal Protection of Investments was signed on November 14, 2005; it has not yet entered into force.

⁴⁵⁾ The Agreement between the People's Republic of China and the Republic of Portugal on the Encouragement and Reciprocal Protection of Investments was signed on December 9, 2005; it has not yet entered into force.

relating to foreign investment. China did not participate in FTAs until quite recently. The first FTA negotiated by China was with the Association of South East Asia Nations (ASEAN) in November 2001.⁴⁶⁾ One year later, a framework agreement was entered into laying out the FTA plan in stages.⁴⁷⁾ The parties agreed to implement an early harvest agreement relating to trade in goods together with a dispute settlement mechanism in July 2005, whilst negotiations on trade in services were aimed to complete in January 2007 for implementation in July 2007.⁴⁸⁾ The objective of the early harvest agreement is for establishing a full FTA by 2010 for the six original ASEAN members and in 2015 for the rest four members.⁴⁹⁾ Investment is part of the overall China-ASEAN FTA. Yet, by early 2009, due to financial tsunami which had an impact on the world economy, negotiations on issues relating to investment had not started.

The China-Chile FTA⁵⁰⁾ also essentially concentrate on trade issues such as elimination of trade barriers, remedies, etc. and almost leaves investment aspect untouched, except by stipulating that the parties shall establish close cooperation

⁴⁶⁾ At the invitation of Malaysian government, the former Chinese Foreign Minister Qian Qichen attended the 24th ASEAN Ministerial Meeting in 1991, which started the bilateral dialogue. China then participated in the 25th ASEAN Ministerial Meeting at the invitation of ASEAN Standing Committee. In 1996, China became a full member of the dialogue at the 29th ASEAN Ministerial Meeting. The formation of a FTA between China and ASEAN was suggested by the former Chinese Premier Zhu Rongji at China-ASEAN summit on November 6, 2001.

⁴⁷⁾ The Framework Agreement on Comprehensive Economic Cooperation between the People's Republic of China and the Association of South East Asian Nations was signed on November 4, 2002 in Phnom Penh and entered into force on July 1, 2003. The Framework Agreement contains 16 articles to set out the principles of cooperation between the parties and to outline a timetable thereof.

⁴⁸⁾ The early harvest program was stipulated in Article 6 of the Framework Agreement.

⁴⁹⁾ As its objective, the Framework Agreement wishes to strengthen and enhance economic, trade and investment collaboration by progressively relaxing trade and other barriers. To achieve the purpose, Articles 2 and 3 provide a timetable for a gradual integration of ASEAN members into their FTA with China.

⁵⁰⁾ Free Trade Agreement between the Government of the People's Republic of China and the Government of the Republic Chile was signed on November 18, 2005 in Pusan, Korea.

aims at “stimulating productive synergies, creating new opportunities for trade and investment”⁵¹⁾ and promoting “the establishment of information exchange channels and facilitate full communication and exchange” in policies, laws and economic information that may affect investment.⁵²⁾ This lack of detailed mechanism on investment was apparently due to China’s inexperience in FTA and its traditional narrow view on FTA.

The most comprehensive FTA that China has entered into is that with New Zealand which was preceded by the China-Pakistan FTA.⁵³⁾ In general, China’s FTA with Pakistan is much less comprehensive than that with New Zealand insofar as bilateral investment is concerned. Both FTAs aim at establishing a mechanism for promoting cross-boarder direct investment.⁵⁴⁾ One of the objectives of the China-New Zealand FTA is to “substantially increase investment opportunities”.⁵⁵⁾ At the same time, China-Pakistan FTA requires the parties to “encourage investors of the other Party to make investments in its territory”.⁵⁶⁾ Yet, the China-Pakistan FTA makes investments to be made “in accordance with its laws and regulations” a condition for qualification of protection, whilst the China-New Zealand FTA does not have the same condition.

In addition to Chapter 11 that deals exclusively with investment issues, the China-New Zealand FTA emphasizes on “creating new opportunities for ...

⁵¹⁾ Article 104(b) of China-Chile FTA.

⁵²⁾ Article 112 of China-Chile FTA.

⁵³⁾ The Free Trade Agreement between the Government of the People’s Republic of China and the Government of the Islamic Republic of Pakistan was entered into on November 24, 2006.

⁵⁴⁾ For the purpose of promoting bilateral investment, China-New Zealand FTA requires the establishment of a Committee on Investment, whilst China-Pakistan FTA has no such arrangement. This difference in arrangement shows that China and New Zealand give bilateral investment a more important role. See Article 150 of China-China-New Zealand FTA.

⁵⁵⁾ Article 2 of China-New Zealand FTA. Other objectives that are investment related include “promote conditions for fair competition in the free trade area”, “provide for the protection and enforcement of intellectual property rights” and “eliminate barriers to trade in ...services”.

⁵⁶⁾ Article 47 of China-Pakistan FTA.

investment”.⁵⁷⁾ This is to echo the objectives of the FTA requiring specific actions of the parties. Such actions include policy dialogue and exchange of information, providing assistance and facilities to business persons, etc.;⁵⁸⁾ the implementation of this obligation requires positive and concrete actions of the parties which include cooperation and information exchange between government institutions, business groups and industrial associations, and holding investment marts.⁵⁹⁾

Another distinct feature of China-New Zealand FTA is its emphasis on the special interest of small and medium-sized enterprises. This is a reflection of the economic and business reality of the bilateral relationship: because of the size of the New Zealand mark, it is more attractive to the small and medium-sized Chinese entities to invest; also the majority of Chinese business entities are also relatively small. Therefore to promote investment by such enterprises is in the interest of China and New Zealand.⁶⁰⁾

II. Qualified Investments and Investors

For promotion and protection of foreign investment, qualification by BITS and FTAs of investments and investors is essential, as whether a given investment or investor should be granted treaty treatment depends on such qualification. In this regard, the China-Norway BIT, one of the earliest bilateral agreements on investment China entered into, provides:

⁵⁷⁾ Article 173(b) of China-New Zealand FTA.

⁵⁸⁾ Article 175.2 of China-New Zealand FTA. No similar provisions are found in China-Pakistan FTA. It is a reflection of China's caution in committing the establishment of a comprehensive mechanism which it may not be able to handle.

⁵⁹⁾ Article 176.2 (a) and (c) of China-New Zealand FTA.

⁶⁰⁾ Most of the provisions of Chapter 14 on Cooperation were related to small and medium-sized enterprises. These provisions require the Contracting Parties to take government measures for promoting co-operations of small and medium-sized enterprises of both countries.

The term “investing” means assets permitted by either contracting party in accordance with its laws and regulations, including, in particular:

- a. Movable and immovable property and other property rights such as mortgages, pledges, liens, usufruct, and other similar rights;
- b. Shares, stock, and debentures of companies or interests in the property of such companies;
- c. Claims to money or to any performance under contract having a monetary value;
- d. Copyrights, industrial property rights (such as patents, trademarks and external designs of industrial products), know-how, and goodwill; and
- e. Concessions conferred by law or under contract permitted by law, including concessions to search for and exploit natural resources.

The definition of “investment” in the China-Norway BIT, though relatively incomplete compared with those of modern ones, has the effect of filling the gap of Chinese law,⁶¹⁾ as in the Chinese legal system, international treaty provisions prevail over local laws in case of conflict.⁶²⁾ That was precisely the use of BITs

⁶¹⁾ None of the Chinese laws contains detailed definition of foreign “investment”. In general, Chinese law regards cash, equipment, technology and intellectual property rights contributed by foreign investors as investment. Yet, it does not define the outer limit of the rights arising from such invested items. For example, Article 5 of the Chinese-foreign Joint Venture Law reads: “Each party to a joint venture may make its investment in cash, in kind or in industrial property rights, etc. The technology and the equipment that serve as the foreign party’s investment must be advanced technology and equipment that actually suit our country’s needs. If the foreign party causes losses by deception through the intentional use of backward technology and equipment, it shall pay compensation for the losses. The investment of a Chinese joint venture may include the right to the use of a site provided for the joint venture during the period of its operation. If the right to the use of the site does not constitute a part of the Chinese party’s investment, the joint venture shall pay the Chinese Government a fee for its use. The various investments referred to above shall be specified in the joint venture contract and articles of association and the value of each (excluding that of the site) shall be jointly assessed by the parties to the venture.”

⁶²⁾ Article 142 of the General Principle of Civil Law of the People’s Republic of China

in the development of the Chinese legal system on protection of foreign investment.

The China-UK BIT, which was agreed upon a few years later, gives investment a broader definition than that of China-Norway BIT. It states, “Investment means every kind of asset accepted as investment by a contracting party” and that it “includes investments existing at the date of entry into force of this Agreement; and a change in the form in which assets are invested does not affect their character as investments”.⁶³⁾ In the current generation of BITs that China has entered into, “investment” has been further expanded. For instance, the 2003 China-Germany BIT defines investment as “every kind of asset invested directly or indirectly by investors of one Contracting Party in the territory of the other Contracting Party”.⁶⁴⁾ With the broad definition to include investment made “indirectly”, the China-Germany BIT’s coverage is much wider than the previous ones.⁶⁵⁾ The China-Germany BIT also enumerates on non-exclusive basis activities that should be considered as investment, including:⁶⁶⁾

provides that where any international treaty concluded or acceded to by China contains provisions differing from those in the laws of the country, the provisions of the international treaty shall apply, unless the provisions are the ones on which China has made a reservation. Article 236 of the Chinese Civil Procedure Law provides that where an international treaty concluded or acceded to by the People’s Republic of China contains provisions differing from those found in this Law, the provisions of the international treaty shall apply, unless the provisions are the ones on which China has announced reservations.

⁶³⁾ Article 1(1)(a) of the 1986 China-UK BIT.

⁶⁴⁾ Article 1(1) of the 2003 China-Germany BIT.

⁶⁵⁾ Article 1(1) of The 1983 China-Germany BIT provides that “Investment” means all the assets under the effective laws of the contracting parties, mainly include: (a) ownership rights of movable and immovable property and other property rights such as mortgages and pledges; (b) shares and other kind of interest in companies; (c) claim to money that can be used in creating economic value or to any other performance having an economic value; (d) copyrights, industrial property rights, technical processes, know-how, trademarks and trade names; and (e) concession rights, including concessions to search for, exploit and extract.

⁶⁶⁾ This is comparable with the recent US model BIT under which “investment” means every asset that an investor owns or controls, directly or indirectly, that has the characteristics of an investment, including such characteristics as the commitment of capital or other resources, the expectation of gain or profit, or the assumption of risk.

- a. movable and immovable property and other property rights such as mortgages and pledges;
- b. shares, debentures, stock and any other kind of interest in companies;
- c. claims to money or to any other performance having an economic value associated with an investment;
- d. intellectual property rights, in particular copyrights, patents and industrial designs, trademarks, trade-names, technical processes, trade and business secrets, know-how and good-will;
- e. business concessions conferred by law or under contract permitted by law, including concessions to search for, cultivate, extract or exploit natural resources.⁶⁷⁾

Compared with the 1983 agreement, the current China-German BIT includes stocks and shares, business secrets and good-will, and concessions to search for cultivate, extract or exploit natural resources as investment. In addition, the open-ended definition of investment – “includes, though not exclusively” – may extend the application of the BIT to any extent.⁶⁸⁾ Obviously in order to maintain the scope of application within the expectation of the parties, the Protocol to the BIT⁶⁹⁾

Forms that an investment may take include: (a) an enterprise; (b) shares, stock, and other forms of equity participation in an enterprise; (c) bonds, debentures, other debt instruments and loans; (d) futures, options, and other derivatives; (e) turnkey, construction, management, production, concession, revenue-sharing, and other similar contracts; (f) intellectual property rights; (g) licenses, authorizations, permits, and similar rights conferred pursuant to domestic law; and (h) other tangible or intangible, movable or immovable property, and related property rights, such as leases, mortgages, liens, and pledges.

⁶⁷⁾ Article 1(1) of the 2003 China-Germany BIT.

⁶⁸⁾ In *Fedax N.V. v. Republic of Venezuela*, promissory notes were taken as qualified investment. One of the rationales for the tribunal for the conclusion was that Article 1 of the Netherlands-Venezuela BIT gave an open-end definition for investment by providing that “the term ‘investments’ shall comprise every kind of asset and more particularly though not exclusively...” See *Fedax N.V. v. Republic of Venezuela* (ICSID Case No. ARB/96/3), Decision on Jurisdiction, July 11, 1997.

⁶⁹⁾ The Protocol and the BIT between China and Germany were signed on the same day. The preamble of the Protocol states: “On signing the Agreement..., the plenipotentiaries, being duly authorized, have, in addition, agreed on the following provisions, which

stipulates that “investments” are those “made for the purpose of establishing lasting economic relations in connection with an enterprise, especially those which [are] allow[ed] to exercise effective influence in its management”. The Protocol further defines indirect investment as those “invested by an investor of one Contracting Party through a company which is fully or partially owned by the investor and having its seat in the territory of the other Contracting Party”. The Protocol is an integral part of the BIT and the two were entered into at the same time. The restrictions made in the Protocol were a compromise of the parties; a Chinese negotiator told this author that the “indirect investment” was too uncertain for China but Germany insisted to have it stipulated in the BIT.⁷⁰⁾ As a result, whilst the BIT explicitly provides for protection of indirect investment, the Protocol stipulates restrictions to narrow down the application of such provisions. This practice also reflects the cultural sensitivity in BIT negotiations.

The China-New Zealand FTA has a wider definition of investment than that of the China-German BIT. It covers, in addition, “bonds, including government issued bonds, debentures, loans and other forms of debt, and rights derived there from;” and “any right conferred by law or under contract and any licenses and permits pursuant to law.”⁷¹⁾ In comparison, the China-Pakistan FTA’s definition of investment is almost identical with that of China-German BIT.⁷²⁾ Another notable difference is that in China-Pakistan FTA, it is provided that “any change in the form in which assets are invested does not affect their character as investments provided that such a change is in accordance with the laws and regulations of the Party in whose territory the investment has been made”, whilst in both China-New Zealand

shall be regarded as an integral part of the said Agreement”.

70) It is also the practice of China in international treaty making that less important provisions and concrete provisions as well as those that may be amended afterwards may be stipulated in a separate document such as a protocol of the main agreement.

71) Article 135 of China-New Zealand FTA. It also stipulates that non-interest bearing loans and other forms of debt should be treated as investments, provided that they are registered with the competent authorities of a Party.

72) Article 46 of China-Pakistan FTA does not include industrial design in its definition of investment.

FTA and China-German BIT, the words “provided ... made” are not included.

The BITs and FTAs that China has entered into turn to list possible areas and activities as investment which is common in international investment treaties. As a consequence, what may constitute an investment is subject to interpretation in practice, which is also often the source for disputes. Although China has not yet been involved in an investor-state arbitration, related decisions made by arbitral tribunals are of significance in determining how the provisions be interpreted in practice. The best known criteria established for determining investment are the “Salini test”, according to which the notion of investment must include the following: (a) a contribution of money or other assets of economic value, (b) a certain duration, (c) an element of risk, and (d) a contribution to the host State’s development.⁷³⁾

China would welcome the “Salini test”, albeit the last one of which has been criticized by some,⁷⁴⁾ as whether a given investment is contributable to the economic development may be difficult to ascertain. As discussed earlier, Chinese law requires foreign investors to contribute advanced technology which in the view of China will contribute to the economic development. Suppose a foreign investor is found having failed to provide advanced technology and the Chinese government, local or central, decides to suspend preferential treatment to the foreign investor. The question whether the investment concerned is qualified for protection must arise. The tribunal in charge will need to decide whether the Chinese authorities were at fault in approving the foreign investment and if not, whether the foreign investor acted deceptively. Any major investment will involve a substantial period of preparation, construction and operation before profit-making. Where the Chinese government, after supposedly examination of documents and business plans of foreign investment, approved the project and later on decides that the investment

⁷³⁾ See *Salini Costruttori S.p.A. and Italstrade S.p.A. v. Kingdom of Morocco*, ICSID Case No. ARB/00/4, Decision on Jurisdiction of 23 July 2001, 42 ILM, 2003, *passim*.

⁷⁴⁾ For instance, it was put in doubt by the tribunal of *L.E.S.I. - DIPENTA v. Republique Algerienne Democratique et Populaire*, Decision on jurisdiction of 12 July 2006, para. 72.

is not qualified to enjoy preferential treatment due to the technology invested being less advanced, arbitral tribunals are unlikely to be sympathetic.⁷⁵⁾ Thus the BITs entered into may play a crucial role in protecting foreign investors' interests.

The BITs entered into by China prior to the mid 1990s all require that investment must be made “in accordance with the laws and regulations” of the host country. The recently concluded BITs, however, do not include such requirement. The China-German BIT simply defines investment as “every kind of asset invested directly or indirectly by investors of one Contracting Party in the territory of the other Contracting Party”.⁷⁶⁾ Article 2 on Promotion and Protection of Investment states that “Each Contracting Party shall encourage investors of the other Contracting Party to make investments in its territory and admit such investments in accordance with its laws and regulations.” It then continues to provide for constant protection and security.⁷⁷⁾ China-New Zealand FTA not only does not require foreign investment to be made by following host country laws but also omits such provisions in the articles stipulating treatment of foreign investments. This is in contrast with the China-Pakistan FTA which contains similar stipulations like those in the first generation BITs of China.⁷⁸⁾

The differences in treaty requirements like those entered into by China on investment making may lead to problems in practice. It can be argued, as China-New Zealand FTA was entered into subsequent to the China-Pakistan FTA and as the former does not require investment to be made “in accordance with the

⁷⁵⁾ For instance, in *Saipem*, the tribunal stated that since “*Saipem* invested substantial technical, financial and human resources in the project, which gave a substantial contribution to Bangladesh’s economic development, and it assumed risks for a significant duration (the performance phase lasted two and a half years)”, the related contract was an investment. *Saipem S.p.A. v. The People’s Republic of Bangladesh*, ICSID Case No. ARB/05/07, Para. 100.

⁷⁶⁾ Article 1(1) of China-German BIT.

⁷⁷⁾ Article 2(2) of China-German BIT.

⁷⁸⁾ Article 46 of China-Pakistan FTA provides the term investment “means every kind of asset invested by investors of one Party in accordance with the laws and regulations of the other Party in the territory of the latter”. It should be noted that the China-Pakistan FTA was concluded before that of the China-New Zealand FTA.

laws and regulations of the host country”, at least the Chinese government was not unaware of the significance of the omission. In practice, such omission may stop China (of course also New Zealand) from claiming an investment to be unqualified. For instance, in *Fraport*,⁷⁹⁾ the term “in accordance with the laws and regulations” was interpreted as a condition for investment making and hence a pre-condition for the giving of consent by the host country for investor-state arbitration. In that case, the BIT between the Philippines and Germany defines investment as “any kind of asset accepted in accordance with the respective laws and regulations of either Contracting State”⁸⁰⁾ and requires the Contracting State to “promote as far as possible investment in its territory by investors of the other Contracting State and admit such investment in accordance with its Constitution, law and regulations.”⁸¹⁾ *Fraport*, the foreign investor, entered into a secret shareholders agreement whereby secured managerial control of the investment project, Terminal 3 of Ninoy Aquino International Airport of the Philippines, in violation of the Philippine Anti-Dummy Law (“ADL”).

The Tribunal of which Professor Michael Reisman was a member held that “In summary, *Fraport* had been fully advised and was fully aware of the ADL and the incompatibility with the ADL of the structure of its investment which it planned and ultimately put into place with the secret shareholder agreements.”⁸²⁾ Based on the fact that the foreign investor knowingly made an investment not “in accordance” with local law, the *Fraport* tribunal decided not to recourse to the object and purpose interpretative technique of treaties to offer protection to the foreign investor. In its view, “It is also clear that the parties were anxious to encourage investments, which are the *raison d’etre* of the treaty. But while a treaty should be interpreted in the light of its objects and purposes, it would be a

⁷⁹⁾ *Fraport AG Frankfurt Airport Services Worldwide v. Republic of the Philippines*, ICSID Case No. ARB/03/25, August 16, 2007.

⁸⁰⁾ Article 1 of the Agreement between the Federal Republic of Germany and the Republic of the Philippines concerning the promotion and Reciprocal Protection of Investments.

⁸¹⁾ *Id.*, Article 2.

⁸²⁾ *Fraport*, para. 327.

violation of all the canons of interpretation to pretend to use its objects and purposes, which are, by their nature, a deduction on the part of the interpreter, to nullify four explicit provisions. Plainly, as indicated by these four provisions, economic transactions undertaken by a national of one of the parties to the BIT had to meet certain legal requirements of the host state in order to qualify as an ‘investment’ and fall under the Treaty.”⁸³⁾ The tribunal hence ruled that ICSID had no jurisdiction on the dispute as the Philippine consent for ICSID arbitration was conditioned on valid investment according to the BIT. Based the rulings of Fraport, even though Chinese law may require foreign investments must meet certain requirements including advanced technology, etc., as international treaty provisions prevail over national laws in case of conflict, the China-New Zealand FTA type agreements may enable foreign investors not to obey the Chinese law. The Chinese government still requires foreign investors to go through approval process when making an investment. Once approval is given, it is more difficult for the Chinese government to argue that a given investment was not made in accordance with Chinese law.

The approval processes may work for China as recipient of foreign capital where foreign investor fails to fully disclose or deliberately makes false disclosure of the information required by law. The case in point is Plama,⁸⁴⁾ where foreign investors failed to disclose the shareholding of the entity through which investment was made, the tribunal held the deliberate concealment of shareholding “amounting to fraud, calculated to induce the Bulgarian authorities to authorize the transfer of shares to an entity that did not have the financial and managerial capacities required”⁸⁵⁾ for an oil refinery. In reaching its decision, the tribunal elaborated at

⁸³⁾ Fraport, para. 340. The Fraport tribunal was obviously convinced by the evidence introduced by the foreign investor that “Even assuming, however, that the ‘preponderance of evidence’ test which applies in civil law must yield in the instant case to a ‘beyond a reasonable doubt’ test because the subject of the ‘in accordance’ inquiry is a Philippine criminal statute, this is a case in which *res ipsa loquitur*. The relevant facts, all of which are found in Fraport’s own documents, are incontrovertible.” *Id.*, para. 399.

⁸⁴⁾ Plama Consortium Limited v. Republic of Bulgaria, ICSID Case No. ARB/03/24, August 27, 2008.

⁸⁵⁾ Plama, para. 135.

length “good faith” as a general principle in business transactions including international investment. The decision of the tribunal apparently rests on the fact that under Bulgarian law, operation of an oil refinery requires approval of the government and that the foreign investor’s concealment of shareholding was for the purpose of obtaining the host government approval which was given upon false qualification of the foreign investor.⁸⁶⁾ In other words, the foreign investor used bad faith as a means to obtain the approval of the host government which in itself violated the local law and as a result was not entitled to the protection of the relevant treaty – Energy Charter Treaty.⁸⁷⁾

Compared with international practice, the lack of requirement of investment making in compliance with the local laws may lead to disputes. For instance, where a foreign investor makes an investment in China and the Chinese government does not raise any questions, in arbitration or other form of dispute resolution, it will be difficult for the Chinese government to avail non-compliance with local law as a basis to exclude the investment from treaty coverage. The only possible defense that China may have is “good faith”. Yet, to what extent this defense can go is still doubtful. In balance, although it is understandable that for purposes of competing with other countries in the region for foreign capital, China decided to eliminate the requirement of compliance with local laws and regulations, in the

⁸⁶⁾ The tribunal stated that “This [non-disclosure of shareholding] may be acceptable in some cases but not under the present circumstances in which the State’s approval of the investment was required as a matter of law and dependant on the financial and technical qualifications of the investor. If a material change occurred in the investor’s shareholding that could have an effect on the host State’s approval, the investor was, by virtue of the principle of good faith, obliged to inform the host State of such change.” See *Plama*, para. 145.

⁸⁷⁾ These rulings are in compliance with the findings of some international organizations. UNCTAD for instance suggests that there should be limitations in interpreting investment agreements, that is “investment that was not established in accordance with the host country’s laws and regulations would not fall within the definition of ‘investment’ as used in the agreement”. The purpose is said “to induce foreign investors to ensure that all local laws and regulations are satisfied in the course of establishing an investment”. See UNNCTAD, *Scope and Definition: UNCTAD Series on issues in international investment agreements* p. 24.

long run China may have to pay a high price. The inconsistency of treaty provisions may further complicate the matter.

With regard to “investors” which is another important aspect of international investment law, the China-Norway BIT does not contain a general definition of “investor” it defines “nationals” as natural persons with the nationality of China or Norway, and “companies” as the legal persons of either party.⁸⁸⁾ At the time of ratifying the China-Norway BIT, China did not have a company law.⁸⁹⁾ The concept of “companies” was unclear. To accommodate both parties, the China-Norway BIT provides that as for China, companies are “economic bodies incorporated and domiciled” in China. In respect of Norway, companies are “judicial persons and sole proprietors domiciled in the territory of Norway, or companies and associations, regardless of whether or not the liabilities of its partners, members or constituents are limited, and regardless of whether their activities are profit-oriented”.⁹⁰⁾ The protection is accorded by one contracting party to nationals and companies of the other.⁹¹⁾

Regarding natural person investors, the China-Germany BIT provides that as neither party recognizes dual-nationality, the national law of each party should be referred to for the purpose of ascertaining nationality issues.⁹²⁾

⁸⁸⁾ Article 3 and 4 of the 1984 China-Norway BIT.

⁸⁹⁾ Before the promulgation of the Company Law in 1993, different Chinese laws governing enterprises were adopted based on the ownership of enterprises. Whilst the Chinese-foreign Joint Venture Law was adopted in 1979, the Law of the People’s Republic of China on Industrial Enterprises Owned by the Whole People was promulgated in 1988.

⁹⁰⁾ Article 4(2) of the 1984 China-Norway BIT.

⁹¹⁾ In theory, the national treatment was mutually applicable to both the Chinese and Norwegian investors. As at that time no Chinese entities making investment in Norway, the benefit of this provision was one sided. It was since 1983 that Norwegian companies started to invest in China. The main sectors of investment are post and telecommunications, electronics, machinery, transportation, light industry, agriculture and environmental protection. Most of the investment projects are located in Eastern coastal cities. See http://www.tpbjc.gov.cn/Article_Show.asp?ArticleID=12803.

⁹²⁾ Article 2(1)(a) and Article 2(2)(a) of the 2003 China-Germany BIT. According to Articles 4, 5, and 6 of the Chinese Nationality Law, any person born in China or abroad whose parents are Chinese nationals or one of them is a Chinese national has the Chinese nationality. Where a person whose parents are Chinese nationals but have

For non-natural-person investors, the China-Germany BIT deleted a provision in the previous BIT that required a Chinese non-natural investor to “be entitled to do business with foreigners” at that time an enterprise that wished to engage in business transactions with a foreign counterpart must first secure approval of the government.⁹³⁾ The current China-Germany BIT sets forth that “economic entities incorporated and constituted under the laws and regulations of China, irrespective of whether or not for profit and whether their liabilities are limited or not” may be qualified as investors on condition that they have their seats/domicile in the territory of China.⁹⁴⁾ The requirement for a German legal person investor is to have its seat in the territory of Germany. This “seat” test, however, may give rise to difficulties, as it is unclear with a mere registration of a company in the territory of either party would satisfy the requirement.⁹⁵⁾ The 2005 China-Finland BIT requires both incorporation and registered office as conditions in determining

settled abroad, or one of whose parents is a Chinese national and has settled abroad, and who has acquired a foreign nationality at birth shall not have the Chinese nationality.

⁹³⁾ Article 7 of the Foreign Economic Contract Law of 1985 provides that Contracts which were subject to the approval of the state, as provided for by the laws or administrative regulations of the People's Republic of China, should be formed only after such approval was granted. With the entering into force of the Contract Law of the People's Republic of China on October 1, 1999, the Economic Contract Law ceased to be effective on the same day. The current Contract Law does not contain provisions requiring commercial contracts with foreign counterparts to be approved before coming into force. Yet, other Chinese laws require certain types of transactions to be subject to government approval.

⁹⁴⁾ Article 2(2)(b) of the 2003 China-Germany BIT.

⁹⁵⁾ Article 2 of the *Company Law of the People's Republic of China* provides, “The term ‘company’ as mentioned in this Law refers to a limited liability company or a joint stock company limited set up within the territory of the People's Republic of China according to the provisions of this Law.” Under Article 10, “A company shall regard its main office as its domicile.” According to Article 39 of the *General Principles of the Civil Law of the People's Republic of China*, “A legal person's domicile shall be the place where its main administrative office is located.” Article 184 of the *Opinions of the Supreme People's Court on Several Issues concerning the Implementation of the General Principles of the Civil Law of the People's Republic of China (For Trial Implementation)* stipulates however that for a foreign legal person, the law of its registration country shall be deemed as its governing law, and the capacity for civil conduct of a legal person shall be determined according to its governing law.

nationality of legal entities.⁹⁶⁾

The China-New Zealand FTA affords protection to enterprise investors which are “constituted or organized under the law of a Party, and a subsidiary located in the territory of a Party and engaged in substantive business operations there”.⁹⁷⁾ A plain reading of the above provision would mean that where an entity from one Party to set up an enterprise (subsidiary) in the territory of the other Party, the subsidiary may not be entitled to the treaty protection unless it engages in substantive business activities. Where the position is clear for entities to set up subsidiaries in the territory of the other Party, there is no similar requirement in relation to natural persons from one Party who have constituted or organized entities in the other Party. This situation is dealt with in Article 149 (Denial of Benefits), subsection (b) of which permits a Contracting Party to deny the benefits to “Investors of the other Party where the investment is being made by an enterprise that is owned or controlled by persons of the denying Party and the enterprise has no substantive business operations in the territory of the other Party.” The word “persons” without doubt covers both legal and natural persons.⁹⁸⁾ The essence of these provisions is to prevent Tokios Tokeles⁹⁹⁾ situation where control test was decided not to apply in determining the nationality of foreign investors.

⁹⁶⁾ The China-Finland BIT defines “investor” as: (b) any legal entity, ...incorporated or constituted under the laws and regulations of either Contracting Party and having its registered office in that Contracting Party.

⁹⁷⁾ Article 135 of China-New Zealand FTA. Natural person investors include those having a permanent status in one of the Parties. As China has not yet any law or regulation giving permanent status to foreigners, the FTA prescribes that upon China adopts such laws, these provisions will apply. In China-Pakistan FTA “investors” include “(a) natural persons who have nationality of either Party in accordance with the laws of that Party; (b) legal entities, including companies, associations, partnerships and other organizations, incorporated or constituted under the laws and regulations of either Party and have their seats in that Party”. See Article 46(3) of China-Pakistan FTA.

⁹⁸⁾ As the “denial of benefit” applies to the matters covered in the entire chapter on investment, all treatments including dispute resolution to foreign investors and investments are likely to be affected.

⁹⁹⁾ Tokios Tokeles v. Ukraine (ICSID Case No. ARB/02/18), 29 June 2007, Award on Jurisdiction.

In Tokios Tokeles, the complainant which was a publishing company of Lithuania, whose 99% shares owned by Ukrainians, established a wholly owned subsidiary (Taki spravy) in Ukraine to conduct publication and advertisement business. Taki Spravy published a book in favor of the opposition leader Yulia Tymoshenko. The Ukrainian government apparently didn't like it and from then on problem began. The Ukrainian government took several measures against Taki Spravy including tax investigation, cancellation of contracts, placing assets under administrative arrest, seizure of financial documents, etc. In the arbitration, the respondent Ukraine argued that Tokios Tokeles was 99% owned by Ukrainians and therefore was not an investor under the investment agreement of the two counties. The Tribunal held that under Article 25(2)(b) of the ICSID Connection, the nationality of juridical persons should be mainly determined on the basis of place of incorporation and that nationality of a company did not depend upon the nationality of the controlling shareholders. In Tokios Tokeles, the foreign investment even did not involve a transfer of funds from Lithuania to Ukrainian. Yet, that did not bother the Tribunal in determining the nature of foreign investment as in its view the source of invested capital did not have to be from a foreign country under the ICSID Convention. This award, albeit it may be intended to advocate the policy for promoting foreign investment, is contrary to the very intent of the ICSID Convention, i.e., to resolve disputes between an investment host country and a foreign national. Unless control test is applied, any investor may make use of the device of incorporation in a foreign country for the purpose of challenging its own government in an international forum.¹⁰⁰⁾ This is the situation that the Chinese government has always tried to avoid.¹⁰¹⁾ The half-way approach taken by the China-New Zealand FTA is apparently another compromise.

¹⁰⁰⁾ For discussions on this point, see the dissenting opinion of president of the Tokios Tokeles tribunal.

¹⁰¹⁾ Even some Chinese scholars have difficulties in accepting the Tokios Tokeles award. See Zhu Yansheng, "The Theories and Practice on the Nationality of Legal Person under the ICSID Regime", *Journal of International Economic Law*, Vol. 13, No. 1 (2006), pp. 244-257.

III. Treatment of Investment

Treatment of foreign investors and investments is the center issue of any BIT. The basis on which to hold the host government responsible is that the body that acts or omits to act is part of the government. Another condition for the host government to be responsible is that the failure of performing the obligation must be proved on the fact that a promise has been made. In *Fireman's Fund Insurance*, a claim was based on the negotiation, development, and ultimate rejection of a Recapitalization Program by a Working Group established by the Mexican Government which argued that no legal claims could be based on the activities of the Working Group, because it was, under the Mexican law, not a governmental organization with decision-making authority or power to bind the State.¹⁰²⁾ The tribunal did not directly address the issue as to whether the Working Group was part of the Mexican government. Rather, it ruled that the “evidence submitted to the Tribunal does not show a case of a commitment made on behalf of Mexico by the Working Group and subsequently repudiated by the State”, as the Working Group was a “forum in which proposals of various kinds were discussed among the relevant Mexican agencies and with interested outside parties, subject at all times to ratification or rejection by the competent government authorities”.¹⁰³⁾ It also stated that the complainant “should have known and did know that while the recommendations of the Working Group were crucial” to decision-making by the government, they were nonetheless recommendations only.¹⁰⁴⁾

BITs seldom list the authorities of the BIT contracting parties whose conduct or omission would attribute to those of the contracting parties. In practice, such issues are determined in accordance with international law in particular customary international law. The Articles on Responsibilities of States for Internationally Wrongful Acts adopted in 2001 by the International Law Commission and

¹⁰²⁾ *Fireman's Fund Insurance Company v. The United Mexican States*, ICSID (Additional Facility), July 17, 2006, Para. 149.

¹⁰³⁾ *Id.*, Para. 150.

¹⁰⁴⁾ *Id.*, Para. 153.

commended to the attention of Governments by the UN General Assembly in Resolution 56/83 of 12 December 2001 (the ILC Articles) are often referred to by tribunals. According to the ILC Articles, the conduct of any state organ, being legislative, executive or judiciary or central or local government bodies, in compliance with the laws of that state, must be considered an act of that state under international law.¹⁰⁵⁾ Such acts are generally referred to as acts of *de jure* organs. An act of state may also be attributed to the conduct of a person or entity which is not a *de jure* organ but which is empowered by the internal law to exercise elements of governmental authority, provided the person or entity is acting in that capacity in the particular instance.¹⁰⁶⁾ Under the Articles of ILC, in fact, even the conduct of a person or group of persons who are not part of the government may be considered an act of their State under international law, provided they act “on the instructions of, or under the direction or control of that State in carrying out the conduct”.¹⁰⁷⁾

Insofar as treatment standard is concerned, around 20% of the BITs that China has entered into provide for national treatment¹⁰⁸⁾ and most of its recently concluded BITs contain the relative treatment standard – either national treatment or MFN treatment with better treatment applicable as well as fair and equitable standard.¹⁰⁹⁾ These standards have been incorporated into the China-Germany BIT

¹⁰⁵⁾ Article 4 of the ILC Articles.

¹⁰⁶⁾ Article 5 of ILC Articles.

¹⁰⁷⁾ Article 8 of ILC Articles.

¹⁰⁸⁾ Among the 117 BITs China has entered into so far only 17 provide for national treatment, whilst the others stipulate fair and equitable treatment as the standard. See Zhang Caixia, “Review and Re-establish the National Treatment System in Sino-Foreign BITs”, *Rule of Law Tribune*, Vol. No. 1, 2007, pp. 240-248.

¹⁰⁹⁾ For example, Article 3 of the 2005 China-Portugal BIT provides: (1) Investments of investors of each Contracting Party shall at all times be accorded fair and equitable treatment in the territory of the other Contracting Party. (2) Each Contracting Party shall accord to investments and activities associated with such investments by the investors of the other Contracting Party treatment not less favorable than that accorded to the investments and associated activities by its own investors. (3) Neither Contracting Party shall subject investments and activities associated with such investments by the investors of the other Contracting Party to treatment less favorable than that accorded

which are applicable to “investments and activities associated with such investments”. It should be noted, however, that it is far from clear as to what may constitute an activity associated with or relating to an investment. The explanation given in the Protocol to the China-Germany BIT offers little assistance in this regard. It sets out: “the following shall more particularly, though not exclusively, be deemed ‘activity’ within the meaning of Article 3 (2): the management, maintenance, use, enjoyment and disposal of an investment.”¹¹⁰⁾ Whatsoever purpose it may try to serve, the term “though not exclusively” should be interpreted to include any activity that may be reasonably justified as related to an investment. Of course, a question that may immediately be raised is whether the national and MFN treatment under the BIT could be applied to pre-investment activities.¹¹¹⁾

The 2004 China-Finland BIT, explicitly stipulates that national treatment is only applied “with respect to the operation, management, maintenance, use, enjoyment, expansion, sale or other disposal of investments that have been made.”¹¹²⁾ At the same time, “With respect to the establishment, acquisition, operation, management, maintenance, use, enjoyment, expansion, sale or other disposal of investments,”¹¹³⁾

to the investments and associated activities by the investors of any third State. Article 3 of the 2005 China-Czech BIT reads: (1) Each Contracting Party shall in its territory accord to investments and returns of investors of the other Contracting Party treatment which is fair and equitable and not less favorable than that which it accords to investments and returns of its own investors or to investments and returns of investors of any third State, whichever is more favorable. (2) Each Contracting Party shall in its territory accord to investors of the other Contracting Party, as regards management, maintenance, use, enjoyment or disposal of their investment, treatment which is fair and equitable and not less favorable than that which it accords to its own investors or to investors of any third State, whichever is more favorable.

¹¹⁰⁾ Ad Article 3 of the Protocol to the Agreement between the People’s Republic of China and the Federal Republic of Germany on the Encouragement and Reciprocal Protection of Investments.

¹¹¹⁾ Chinese law has no provisions for pre-investment national treatment. China is now an observer of the Energy Charter Treaty which requires pre-investment to be afforded national treatment. It is therefore not unforeseeable that China may accept pre-investment national treatment in its BITs as that will give additional protection to its investment abroad.

¹¹²⁾ Article 3(2) of the 2005 China-Finland BIT.

the MFN treatment applies. Like the NAFTA Agreement, the China-Finland BIT provides that “each Contracting Party shall accord to investments by the investors of the other Contracting Party the treatment, which, according to the investor is more favorable,”¹¹⁴⁾ which means that the investors concerned may choose what treatment to receive. In this regard, there would not be any problem as China has always accorded foreign investors more favorable treatment than that to its own nationals.¹¹⁵⁾

Concerning the treatment standards, the following China-Portugal BIT is typical in which reference is made to international law, Article 10(1) of which states, “if the provisions of law of either Contracting Party or obligations under international law existing at present or established hereafter between the Contracting Parties in addition to the present Agreement contain regulations entitling investments by investors of the other Contracting Party to a treatment more favourable than is provided for by the present Agreement, such regulations shall, to the extent that they are more favourable, prevail over the present Agreement.”¹¹⁶⁾ Such provisions may beg more questions than resolving any, as what may constitute international standard is, to say the least, very uncertain.¹¹⁷⁾ The situation that they may catch

¹¹³⁾ Article 3(3) of the 2005 China-Finland BIT.

¹¹⁴⁾ Article 3(4) of the 2005 China-Finland BIT.

¹¹⁵⁾ For example, according to the Circular of the State Council of China on Adjustment of Imported Equipment Taxation Policies, the State Council decided that starting from January 1, 1998, imported equipment of domestic investment projects and foreign investment projects encouraged by the State shall enjoy exemption from tariff and import stage value-added tax within the specified scope. Before January 1, 2007 when the Decision of the State Council on Amending the Interim Regulations of the People's Republic of China on City and Town Land Use Tax entered into force, foreign-invested enterprises had been exempted from the land use tax. They also enjoyed lower income tax before January 1, 2008 when the Enterprise Income Tax Law entered into force.

¹¹⁶⁾ Article 10(1) of the 2005 China-Portugal BIT, http://www.chinahotelsreservation.com/china_law/Agreement_between_china_law_the_Government526.html. Other BITs that include the same provisions include China-Tunisia BIT (2004), the China-Bosnia BIT (2002), and the China-Netherlands BIT (2001).

¹¹⁷⁾ The Neer case was regarded as the historical starting point of the standard of treatment to foreigners. According to the Commission, “the treatment of an alien, in order to constitute an international delinquency, should amount to outrage, to bad faith, to

is that when China joins the Energy Charter Treaty and gives pre-investment national treatment to foreign investors.

As discussed earlier, in China's practice, the protection and treatment, both national and most favored treatment, offered to investors are without exceptions. This is in contrast with NAFTA, Article 1410(1) of which provides: "Nothing in this Part shall be construed to prevent a Party from adopting or maintaining reasonable measures for prudential reasons", even if the effect of such measures (as contrasted with their motive or intent) is discriminatory.¹¹⁸⁾ The NAFTA exception of prudential measures is apparently confined to financial measures.¹¹⁹⁾ In China's specific commitments relating to service sector for joining the WTO, a similar provision was included. As it is very difficult, if not impossible, to draw a line between investment and trade in services in most of the cases, in practice this may cause difficulties. For instance, where a measure is introduced by the Chinese

willful neglect of duty or to an insufficiency of governmental action so far short of international standards that every reasonable and impartial man would readily recognize its insufficiency." See L. F. H. Neer and Pauline Neer (USA) v. United Mexican States, October 15, 1926, para. 4, in United Nations, *Reports of International Arbitral Awards* (2006), pp. 60-66. In practice, however, some tribunals departed from the high standard and held that the minimum standard was evolving with time passing by. For example, in the ADF case, the tribunal interpreted customary international law referred in Article 1105(1) of the NAFTA as "not 'frozen in time' and that the minimum standard of treatment does evolve...what customary international law projects is not a static photograph of the minimum standard of treatment of aliens as it stood in 1927 when the Award in the Neer case was rendered. For both customary international law and the minimum standard of treatment of aliens it incorporated are constantly in a process of development." ADF Group Inc. v. USA, Award of January 9, 2003, para 179.

¹¹⁸⁾ Fireman's Fund Insurance Company v. The United Mexican States, ICSID (Additional Facility), Para. 162.

¹¹⁹⁾ Olin L. Wethington, the US principal negotiator for financial service under NAFTA writes: "Article 1410(1)(a) ... carves out of the national treatment and other obligations of the financial services chapter a right to take reasonable measures even though discriminatory in application, to protect the safety and soundness of the financial system. This regulatory prerogative to protect the integrity of the financial system is accepted internationally." Olin L. Wethington, *Financial Market Liberalization*, at ss 5.07 (Sheppard's McGraw Hill 1994).

government pursuant to the prudential principle under the General Agreement on Trade in Services (“GATS”), it may be judged against the provisions of BITs relating to fair and equitable treatment, national treatment, etc. As the WTO dispute resolution mechanisms only permit Members to institute complaints, private investors are likely to choose international arbitration as forum for resolving their disputes with the Chinese government. In the circumstance, may the Chinese government use GATS compliance as a defense for not providing fair and equitable treatment or national treatment?

The fair and equitable treatment has already become a standard treatment in China's recent BITs the China-Germany BIT, the China-Finland BIT, the China-Spain BIT and the China-Portugal BIT have all adopted largely the following “investments of investors of each Contracting Party shall at all times be accorded fair and equitable treatment in the territory of the other Contracting Party”.¹²⁰⁾ The China-Russia BIT concluded in 2006 followed the precedents even though it adopted a slightly different wording.¹²¹⁾

The fair and equitable treatment is not a new concept in international investment law. Yet, recent arbitral awards involving Argentina and other countries have certainly sent a strong signal that the clause may have devastating impact on the legal system and laws of the host countries.¹²²⁾ China was of course not unaware

¹²⁰⁾ Article 3(1) of the 2003 China-Germany BIT, Article 3(1) of the China-Finland BIT, Article 3(1) of the China-Spain BIT, and Article 3(1) of the China-Portugal BIT.

¹²¹⁾ Article III (1) of the 2006 China-Russia BIT provides that “each Contracting Party shall ensure in its territory fair and equitable treatment of the investments made by investors of the other Contracting Party and activities in connection with such investments.”

¹²²⁾ Currently no consensus has been drawn out of international arbitration practice. Where the factual situations are the same, different arbitration tribunals, relying on different BIT with almost identical provisions, came to contradictory decisions relating to the host country's obligations under the fair and equitable treatment. See *CME Czech Republic B. V. v. The Czech Republic*, UNCITRAL and *Lauder v. The Czech Republic*, UNCITRAL. Of course, it may be argued that in every legal proceeding, there are always at least two lawyers, that is every provision may be subject to two interpretations. It is equally true that judges of the same court or different courts may take different views on the same legal issue. The fact of inconsistency in arbitration practice may,

of the potential consequence of the fair and equitable clause. Yet it still decided to have the clause stated in its BITs which shows that China is determined to be a responsible member of the international community and to let its laws and administrative decisions be subject to the scrutiny of international arbitration.¹²³⁾ For a country with the communist party at the helm of affairs, this is in itself an important contribution to international investment law.

The China-New Zealand FTA, as a matter of principle, does not apply to trade in services. Yet, it extends its application to government measures that affect the supply of services through commercial presence in respect of transfer of funds, fair and equitable treatment, compensation, expropriation and subrogation. In such matters, a service supplier may invoke the investor-state dispute settlement mechanism in resolving their differences with the host government.¹²⁴⁾

Constant protection and security, fair and equitable treatment, national treatment and MFN treatment have now become standard treatment in China's BITs. The China-Pakistan FTA follows the suit of China-German BIT including the limitations with regard to application of the MFN treatment.¹²⁵⁾ Article 48(3) of China-Pakistan FTA modified China-German BIT slightly by providing the MFN treatment shall not authorize the benefit of any treatment, preference or privilege "by virtue of:

however, hinder the acceptance of the provisions, although no solution is yet available.

¹²³⁾ Once an arbitration tribunal decides that China is in breach of its obligations under the fair and equitable treatment clause, it is bound to amend its laws if the legal provisions are the source of the breach or to change the behaviors of the government if such behaviors are questioned. It is exactly in this context that BITs will have an important effect on Chinese laws and government decision-makings.

¹²⁴⁾ Article 137 of China-New Zealand FTA. The measures affecting services do not include subsidies provided by a Party or "laws, regulations, policies and procedures of general application governing the procurement by government agencies of goods and services purchased for governmental purposes and not with a view to commercial resale or with a view to use in the production of goods or the supply of services for commercial sale." See Article 137(5) of China-New Zealand FTA.

¹²⁵⁾ It is also provided that where the laws of either Party or international obligations existing at conclusion of the FTA or established thereafter between the Parties result in more favorable treatment to the investments of the investors from the other Party than that provided by the FTA, the more favorable treatment should apply. See Article 55 of China-Pakistan FTA.

(a) any other customs union, free trade zone, economic union and any international agreement resulting in such unions, or similar institutions; (b) any international agreement or arrangement relating wholly or mainly to taxation; (c) any arrangements for facilitating small scale trade in border areas.” The China-New Zealand FTA has, however, adopted a much elaborated standards. In terms of national treatment, it stipulates the specific areas should include “management, conduct, operation, maintenance, use, enjoyment or disposal, by the investors” to their investment and associated activities.¹²⁶⁾ It also makes like circumstances as the condition for affording national treatment.¹²⁷⁾

There are also restraints on the application of national treatment provisions. They include (1) the existing non-conforming measures, (2) continuation and amendments of non-conforming measures provided that such amendments do not increase the degree of non-conformity, and (3) a measure that would not fall into the national treatment obligations under an existing bilateral investment treaty that a Party has concluded.¹²⁸⁾ This having been stipulated, the Parties are under an obligation to remove the non-conforming measures progressively.¹²⁹⁾

China-New Zealand FTA also explicitly stipulates that dispute resolution procedures under other arrangements do not apply to investors of any party, nor any differential treatment to third countries “under any free trade agreement or multilateral international agreement”.¹³⁰⁾ Differential treatment involving fisheries and maritime matters under international agreements may also be considered as exceptions to the MFN

¹²⁶⁾ Article 138 of China-New Zealand FTA. In both China-Pakistan FTA and BITs that China has entered into recently do not have such detailed provisions.

¹²⁷⁾ *Id.*

¹²⁸⁾ Article 141 of China-New Zealand FTA.

¹²⁹⁾ China-New Zealand FTA does not provide specifically what may constitute a non-conforming measure. It instead incorporates the provisions of the WTO Agreement on Trade-Related Investment Measures *mutatis mutandis*. See Article 141 of China-New Zealand FTA.

¹³⁰⁾ Article 139 of China-New Zealand FTA. This exclusion includes “agreements on the liberalization of trade in goods or services or investment, any measures taken as part of a wider process of economic integration or trade liberalization between the parties to such agreements”.

treatment.¹³¹⁾

The China-New Zealand FTA puts fair and equitable treatment and full protection and security in the same paragraph which requires the Parties to accord the treatment “in accordance with commonly accepted rules of international law”.¹³²⁾ It further elaborates that fair and equitable treatment includes “the obligation to ensure that, having regard to general principles of law, investors are not denied justice or treated unfairly or in equitably in any legal or administrative proceeding affecting the investments of the investor”, whilst full protection and security “requires each Party to take such measures as may be reasonably necessary in the exercise of its authority to ensure the protection and security of the investment”.¹³³⁾ Under China-New Zealand FTA, fair and equitable treatment and full protection and security require the host government not to take any measures that may result in unreasonable or discriminatory treatment against the “management, maintenance, use, enjoyment and disposal of the investments”. This is by far the most elaborated provision on the subject that China has committed itself. Yet, China-New Zealand FTA also stipulates that violation of other articles “does not establish that there has been a violation” of the article on fair and equitable treatment and full protection and security.¹³⁴⁾ This is so because fair and equitable treatment requirement is bound to have significant impact on the laws and legal systems of the host country. What is fair and equitable, without treaty obligations, would be the entire decision of administrative and judicial bodies. With the provisions of China-New Zealand FTA, China must ensure that its decision-making complies with internationally recognized practice in particular due process.

¹³¹⁾ Article 139(5) of China-New Zealand FTA.

¹³²⁾ Article 143(1) of China-New Zealand FTA. This arrangement of wording is very different from other FTAs and BITs that China has entered into. Whether or not this will become the practice of China is worth observing.

¹³³⁾ Article 143(2) and (3) of China-New Zealand FTA.

¹³⁴⁾ As mentioned earlier, China-New Zealand FTA puts fair and equitable treatment and full protection and security in Article 143. In BITs that China signed recently and China-Pakistan FTA, fair and equitable treatment is provided in one article, while protection and security are in another. Also, instead of “full”, they both use the adjective “constant” before the words protection and security.

On the transfer of funds in respect of making an investment, investment returns, payments arising from royalties, concessions, loan contracts, liquidation of investments, expropriation, restitution or compensation as a result of losses owing to war, armed conflict or a state of national emergency, insurrection or riot, etc., China-New Zealand FTA contains the common provisions of the China-German BIT and China-Pakistan FTA.¹³⁵⁾ In addition, China-New Zealand FTA provides: (1) detailed arrangements for exchange rates, (2) China may retain its foreign exchange control provided that MFN treatment obligation is observed and the measures are not excessively burdensome on the investors, (3) both Parties may restrain, on the basis of equity, non-discrimination and good faith and through laws, transfer relating to:

- a. bankruptcy, insolvency, or protection of the rights of creditors;
- b. issuing, trading or dealing in securities, futures or derivatives;
- c. criminal or penal offences;
- d. financial reporting or record keeping of transfers when necessary to assist law enforcement or financial regulatory authorities; or
- e. ensuring compliance with orders or judgments in judicial or administrative proceedings.¹³⁶⁾

What should also be noted is that Article 142 of China-New Zealand prohibits both parties from requiring their own nationals to transfer back their “income, earnings, profits or other amounts derived from or attributable to investments in the territory of the other Party” or penalize those who fail to transfer.¹³⁷⁾ China has currently such requirements. As a compromise, the FTA permits China not to be subject to the above provisions on condition that Chinese laws and regulations so provide.¹³⁸⁾

¹³⁵⁾ China-Pakistan FTA's provisions on transfer are almost identical with those in China-German BIT.

¹³⁶⁾ Article 142(4) of China-New Zealand FTA.

¹³⁷⁾ Article 142(5) of China-New Zealand FTA.

¹³⁸⁾ The significance of this provision is that once China abandons the current transfer back requirement, it may not re-introduce such rules. See Article 142(7) of China-New Zealand FTA.

It is debatable whether BITs and FTAs should allow investors from third parties (non-parties) to have a free ride and whether substantive business should be a precondition for such investors to be afforded protection. China-New Zealand FTA took the conservative or cautious position by stipulating substantive business operation as a condition for investors from a third party to enjoy the treaty protection.¹³⁹⁾ This also applies to situations where an investment is made by an enterprise owned or controlled by persons of a non-Party which has the legal person status of either Party to the FTA. This provision may in practice exclude the jurisdiction of ICSID.¹⁴⁰⁾

Applicable law relating to investment contract is of course as important as the requirement on the forum for dispute resolution. Chinese law requires all foreign direct investment contracts to be governed by Chinese law which should be regarded as covering both substantive law and conflict of law issues. This requirement may not affect the interpretation of BITs that China has entered into. Yet, once it comes to the issue as to whether a foreign investor or its investment has been treated properly, unless international law requires otherwise, Chinese law may have to be consulted. For instance, where a foreign investor wishes to import a machinery, the applicable customs duties will have to be ascertained according to Chinese law, based on which whether the foreign investor is treated fairly and equitably will be determined. This arrangement is in compliance with the ICSID Convention, Article 42(1) of which stipulates that tribunals must apply the laws and rules agreed upon by the parties and that “In the absence of such agreement, the Tribunal shall apply the law of the Contracting State party to the dispute (including its rules on the conflict of laws) and such rules of international law as may be applicable.”

¹³⁹⁾ Article 149 of China-New Zealand FTA.

¹⁴⁰⁾ Under Article 25(2)(b) of the ICSID Convention, where a juridical person has the nationality of a State, but because of foreign control, the State Parties may agree not to grant the same treatment to the judicial person as that other judicial persons of the same State are entitled to.

IV. Expropriation and Compensation

Large scale or open expropriation is no longer a main threat to contemporary international investment. Indirect and creeping expropriation often triggers disputes however. As one of the host countries which have attracted largest foreign capital, China has always paid particular attention to the issue of expropriation but essentially limited to the traditional thinking. For instance, the China-Norway BIT stipulates for expropriation of foreign direct investments for public purpose.¹⁴¹⁾ In addition, it requires the country carrying out the expropriation or nationalization to apply the principle of nondiscrimination.¹⁴²⁾

With regard to compensation for expropriation, the China-Norway BIT made some progress from the Chinese Joint Venture Law by providing:¹⁴³⁾

Compensation shall be made without undue delay and shall be realizable and freely transferable. It shall amount to the value of the investment immediately before the expropriation, and shall include interest until the date of payment.

This of course does not meet the requirements of the Hull Rule – host state is required to pay prompt, adequate and effective compensation.¹⁴⁴⁾ Yet, considering the fact the Chinese law at that time was quite primitive and that China was the pure recipient of foreign capital,¹⁴⁵⁾ it was an important step in subjecting the country to international norms.

China-UK BIT brought China closer to the general practice of developed countries. Rather than recognizing the expropriation as a right of states, it prescribes “Investments ... shall not be expropriated, nationalized or subjected to measures

¹⁴¹⁾ Article 5(1) of the 1984 China-Norway BIT.

¹⁴²⁾ Article 5(1) of the 1984 China-Norway BIT.

¹⁴³⁾ Article 5(2) of the 1984 China-Norway BIT.

¹⁴⁴⁾ The Hull Rule was articulated in 1938 by U.S. Secretary of State Cordell Hull in response to Mexican expropriation of U.S. agricultural and oil interests and became the cardinal principle of U.S. custom in this sphere. See M. Sonarajah, *The International Law on Foreign Investment*, 1994, pp. 229-230.

¹⁴⁵⁾ It was since 1979 that China started to invest abroad. Initially, most of its investments went to construction and catering. See <http://www.chinapilot.net/Economy/01/05/article/114.htm>.

having effect equivalent to expropriation or nationalization” except for a public purpose and against compensation.¹⁴⁶⁾ Expropriation or nationalization conditioned on public purpose and compensation was not a prevailing view among Chinese academics at that time.¹⁴⁷⁾ It was truly a significant move on the part of China.

The China-UK BIT still adopts the “reasonable compensation” standard in general terms. Yet, immediately thereafter, the reasonable standard is further stated as “Such compensation shall amount to the real value of the investment expropriated immediately before the expropriation or impending expropriation became public knowledge, shall include interest at the normal rate until the date of payment, shall be made without undue delay, be effectively realizable and be freely transferable.”¹⁴⁸⁾ It should be noted that the prevailing Chinese view on compensation for expropriation then was “reasonable compensation”. The wording of the China-UK BIT was obviously to adopt the Hull Rule in effect, whilst giving lip-service to the “reasonable compensation” in order to quiet potential internal criticisms.¹⁴⁹⁾ Actually the adoption of the standard in the BIT surprised a lot of Chinese and

¹⁴⁶⁾ According to Chinese traditional view, the right to expropriation comes from the sovereignty of a state, any condition attached by the Western developed countries to legitimate expropriation is unjustified. However, Article 5 of the China-UK BIT seems to admit that China has given up the right to expropriate foreign investments unless the two conditions are met.

¹⁴⁷⁾ In 1980’s, by referring to the Charter of Economic Rights and Duties of States, right to expropriation or nationalization was recognized as an important aspect of sovereignty over natural resource. See Wang Tieya, *International Law*, Law Press, 1981, pp. 430-431; Prof. Yao Meizhen held that nationalization conditioned on public purpose and compensation was based on the capitalist doctrine of inviolability of private property which was totally unacceptable theoretically, as the right of nationalization was an attribute of sovereignty. For details, see Yao Meizhen, *International Investment Law*, Wuhan University Press, 1989, p. 379.

¹⁴⁸⁾ Article 5(1) of the 1986 China-UK BIT.

¹⁴⁹⁾ In Chinese culture at that time, any major concession made to foreign countries may be considered as non-patriotic and deviation from the socialism, and would be subject to criticisms. This was more so in the mid 1980s, as there were hot debates as to what measures should be considered as reforms and what as adopting the techniques of capitalism. The debates ended with Deng Xiaoping’s tour in southern China when he stated that nothing was exclusively patented for capitalism. For discussions on this issue, see Guiguo Wang, *Wang’s Business Law of China*, *surpra*.

foreign scholars as in other official documents China still refused to recognize the Hull Rule as acceptable standard.¹⁵⁰⁾

It is also stipulated in the China-UK BIT that “The national or company affected shall have a right, under the law of the Contracting Party making the expropriation to prompt review, by a judicial or other independent authority of that party, of his or its case and of the valuation of his or its investment in accordance with the principles set out in this paragraph.”¹⁵¹⁾ Judicial review of administrative actions at that time was unheard of in the Chinese legal system.¹⁵²⁾ By granting foreign investors such right in case of expropriation amounted to inserting “judicial review” into the Chinese system.¹⁵³⁾ As international treaty provisions have the effect of filling the gap and prevailing over any conflicting provisions of Chinese law, this prescription serves as a tool to move international norms into the Chinese domestic law.¹⁵⁴⁾

A common feature of the BITs that China has entered into lately is making

¹⁵⁰⁾ Article 5 of the Law on Wholly Foreign-owned Enterprises, *supra*. Also it should be noted that at that time China was the pure recipient of direct foreign investment. With its investment in foreign countries growing rapidly after the turn of the century, it is in China's interest to ensure adequate compensation for expropriation.

¹⁵¹⁾ Article 5(1) of the 1986 China-UK BIT.

¹⁵²⁾ In the Protocol on the Accession to the WTO, China agreed that there shall in all cases be an opportunity for an impartial and independent judicial body to review specified administrative actions. Under the current Chinese legal system, judicial review is only available to concrete administrative actions through the means of administrative litigation. By contrast, based on the doctrine of separation of power, under the common law, judicial review includes constitutional review of legislations. For discussions on judicial review in China, see Hu Jinguang, “The Space of Chinese Judicial Review”, *Henan Social Science*, Vol. 14, No. 5, (September 2006), pp. 72-76.

¹⁵³⁾ It was most probably the first time that a bilateral agreement had such important effect on the Chinese legal system.

¹⁵⁴⁾ A distinct feature of globalization is that international norms have direct effect on national legal systems. With China joining the World Trade Organization, international norms moving into the Chinese legal system, laws and law enforcement mechanisms has become a natural consequence of concluding international agreements. For discussion on the issue, see Guiguo Wang, “Globalizing the Rule of Law”, *Indian Journal of International Law*, Vol. 48, No. 1, 2008, pp. 21-44.

expropriation conditional. Nearly all of these BITs contain the following provisions:¹⁵⁵⁾

Neither Contracting Party shall expropriate, nationalize or take other similar measures against the investments of the investors of the other Contracting Party in its territory, unless the measures taken meet the following conditions: (a) for the public interests; (b) under domestic legal procedure; (except for the 2003 China-Germany BIT); (c) without discrimination; and (d) against compensation.

Regarding compensation for expropriation, the 2003 China-Germany BIT stipulates that “such compensation shall be equivalent to the value of the investment immediately before the expropriation is taken or the threatening expropriation has become publicly known, whichever is earlier.”¹⁵⁶⁾ In comparison, the 2006 China-Russia BIT, 2004 China-Finland BIT, the 2005 China-Spain BIT and the 2005 China-Portugal BIT provide that the compensation “shall be equivalent to the fair market value of the expropriated investment at the time immediately before the expropriation was taken or the impending expropriation became public knowledge, whichever is earlier.”¹⁵⁷⁾ This slightly different version may not necessarily lead to arguments that the “value” under the 2003 China-Germany BIT is not “market value” of the investment in question, even though arbitration practice does not provide a definite answer.¹⁵⁸⁾

Without exception, all the above-mentioned BITs contain clauses that compensation must be paid without undue delay, including interest, effectively realizable and freely transferable.¹⁵⁹⁾ These provisions are in essence a reflection of the Hull

¹⁵⁵⁾ For example, Article 4 of 2005 China-Portugal BIT, Article 4 of the 2005 China-Spain BIT and Article 4 of the 2004 China-Finland BIT.

¹⁵⁶⁾ Article 4(2) of the 2004 China-Germany BIT.

¹⁵⁷⁾ Article 4(2) of the 2006 China-Russia BIT, Article 4(2) of the 2004 China-Finland BIT, Article 4(2) of the 2005 China-Spain BIT, and Article 4(2) of the 2005 China-Portugal BIT.

¹⁵⁸⁾ The issue relating to compensation is what it should include. For instance, in addition to the investment made, whether profits should be part of the market value and if “yes”, whether such profits should be ascertained after deduction of future cash flows or loss. In CME, Professor Brownlie obviously held a different view. See the Separate Opinion of Brownlie in CME Czech Republic B.V. v. The Czech Republic.

Rule. These provisions of the recent Chinese BITs confirm that China has accepted the standard.¹⁶⁰ None of these BITs however contain detailed rules on how the market value should be calculated, whether the Discounted Cash Flow Method (DCF) could be employed, whether the expected profits should be compensated, and what may constitute expected profits.¹⁶¹ Such issues will have to be dealt with by arbitral tribunals or the courts in practice. It will be interesting to observe how international investment arbitration and treaty practice may affect interpretation of these BITs with China.

All the recent BITs with China contain rules on indirect expropriation in the form "other legal measures having similar effect",¹⁶² which is similar with that in

¹⁵⁹) Article 4(2) of the 2003 China-Germany BIT provides that "Such compensation shall be equivalent to the value of the investment immediately before the expropriation is taken or the threatening expropriation has become publicly known, whichever is earlier. The compensation shall be paid without delay and shall carry interest at the prevailing commercial rate until the time of payment; it shall be effectively realizable and freely transferable." Similarly, Article 4(2) of the 2005 China-Portugal BIT states "The compensation shall be paid without delay; it shall be effectively realized and freely transferred." Article 4(3) of the 2004 China-Finland BIT stipulates: "Compensation shall be fully realizable and shall, in order to be effective for the affected investor, be paid without delay. It shall include interest at a commercial rate established on a market basis for the currency of payment from the date of dispossession of the expropriated property until the date of actual payment."

¹⁶⁰) In comparison, the 1984 China-Finland BIT provided that "payment of compensation shall not be delayed without reasonable excuse", indicating that it could be delayed where valid reasons existed. This was also true for the 1983 China-Germany BIT which provided that "payment of compensation shall not be delayed inappropriately". There were no specific standards of compensation in the 1983 China-Germany BIT either.

¹⁶¹) It should be noted that in CME, Professor Brownlie was strongly against inclusion of uncertain and speculative future profits into market value. He also argued that when deciding the genuine value of an investment, the status of international law at the time when the BIT in question was entered into should be taken into account. Based on this theory, Professor Brownlie stated "The standard of appropriate or just compensation carries the strong implication that, in the case of a going concern and more generally, the compensation should be 'subject to legitimate expectations and actual conditions', as Schachter indicates. Schachter's assessment coincides with the period in which the relevant treaty was concluded." See Par. 32 of the Separate Opinion of Brownlie in CME Czech Republic B.V. v. The Czech Republic.

the NAFTA Agreement.¹⁶³⁾ This however offers little help with regard to issues such as what specific measures may constitute indirect or creeping expropriation. As some commentators pointed out, “in any case, the wording of the existing investment treaties have failed to address the indirect expropriation problem, on the contrary, it brings forward this question, and assume that general international law can provide the answer.”¹⁶⁴⁾ The fact that the United States and Canada not long ago began to stipulate detailed rules in their BIT is seen as a response to such criticism and the situation that more and more disputes in international investment were related to indirect expropriation within the NAFTA framework.¹⁶⁵⁾

In the Protocol of China-India BIT signed in 2006, the criteria for indirect expropriation were stipulated in detail with a balanced emphasis on results and purposes as follows:¹⁶⁶⁾

- (1) A measure of expropriation includes, apart from direct expropriation or nationalization through formal transfer of title or outright seizure, a measure or series of measures taken intentionally by a Party to create a situation whereby the investment of an investor may be rendered substantially unproductive and incapable of yielding a return without a formal transfer of title or outright seizure.
- (2) The determination of whether a measure or a series of measures of a Party

¹⁶²⁾ See for example, Article 4(2) of the 2003 China-Germany BIT, Article 4(1) of the China-Portugal BIT and Article 4(1) of the China-Finland BIT.

¹⁶³⁾ Article 1100(1) of NAFTA provides that “No Party may directly or indirectly nationalize or expropriate an investment of an investor of another Party in its territory or take a measure tantamount to nationalization or expropriation of such an investment (“expropriation”).”

¹⁶⁴⁾ Rudolf Dolzer, “Indirect Expropriation: New Development?” *New York University Environmental Law*, Vol. 11, 2002, p. 79.

¹⁶⁵⁾ For example, *Metalclad Corporation v. Mexico*, *S. D. Myers, Inc. v. Canada*, *Pope & Talbot Inc. v. Canada*, *Methanex v. U.S.*

¹⁶⁶⁾ Article III (Ad Article 5) of the Protocol to the Agreement between the Republic of India and the People’s Republic of China on Promotion and Protection of Investments, III. Ad Article 5.

in a specific situation, constitute measures as outlined in paragraph 1 above requires a case by case, fact based inquiry that considers, among other factors:

- (i) the economic impact of the measure or a series of measures, although the fact that a measure or series of measures by a Party has an adverse effect on the economic value of an investment, standing alone, does not establish that expropriation or nationalization, has occurred;
 - (ii) the extent to which the measures are discriminatory either in scope or in application with respect to a Party or an investor or an enterprise;
 - (iii) the extent to which the measures or series of measures interfere with distinct, reasonable, investment-backed expectations;
 - (iv) the character and intent of the measures or series of measures, whether they are for *bona fide* public interest purposes or not and whether there is a reasonable nexus between them and the intention to expropriate.
- (3) Except in rare circumstances, non-discriminatory regulatory measures adopted by a Contracting Party in pursuit of public interest, including measures pursuant to awards of general application rendered by judicial bodies, do not constitute indirect expropriation or nationalization.

In practice, a measure may include a law or regulation or decree or a final court judgment.¹⁶⁷⁾ In particular, the so-called creeping expropriation may involve a variety of actions or omissions by the government as a whole. This was eloquently stated by the International Court of Justice in Fisheries Jurisdiction case¹⁶⁸⁾ that “in its ordinary sense the word [measure] is wide enough to cover any act, step or proceeding, and imposes no particular limit on their material content or on the

¹⁶⁷⁾ See *The Loewen Group, Inc. and Raymond L. Loewen v. United States of America*, ICSID Case No. ARB(AF)/98/3, 5 January 2001. The tribunal held that the “rule of judicial finality (often described as ‘substantive’) was thought to be directed to the responsibility of the State for judicial acts.” *Ib.*, para. 68. The tribunal however distinguished judicial “affirmation of a general principle” from a specific order and considered only the former would constitute a measure. *Id.*, para. 52.

¹⁶⁸⁾ *Fisheries Jurisdiction case (Spain v. Canada)*, Jurisdiction of the Court, Judgement of 4 December 1998, I.C.J. Report 1998.

aim pursued thereby.”¹⁶⁹⁾

The importance of treaty provisions on expropriation and compensation is that what action or omission may constitute expropriation would, via BIT, be decided by international arbitration tribunals in accordance with the Vienna Convention on the Law of Treaties¹⁷⁰⁾ rather than the domestic law of the contracting parties.¹⁷¹⁾

It is precisely in this sense, the treaty provisions have taken the power of interpretation away from the national courts.

The FTAs of which China is a party also consistently take the position that expropriation must meet the following conditions:¹⁷²⁾

- a. for a public purpose;
- b. in accordance with domestic laws;
- c. being carried out in a non-discriminatory manner; and
- d. on payment of compensation.

At the same time, China-New Zealand FTA provides that expropriation must not be contrary to any undertaking that the Party concerned has given.¹⁷³⁾

Like most other BITs, none of the Chinese BITs has defined the term “expropriation”. In practice, when deciding what may constitute an “expropriation”, arbitral tribunals sometimes take the following into account:

- a. There must be a taking by the host government or its agency of an investment

¹⁶⁹⁾ *Id.*, p. 432, para. 65.

¹⁷⁰⁾ International practice in particular the dispute resolution practice of the WTO shows that tribunals are very much prepared to interpret treaties, bilateral or multilateral, according to the Law of Treaties.

¹⁷¹⁾ For standards of determining indirect expropriation, also see L. Yves Fortier, Stephen L. Drymer, “Indirect Expropriation in the Law of International Investment: I Know It When I See It, or Caveat Investors”, *ICSID Review*, 2004, Volume 19; Number 2, pp. 293-327.

¹⁷²⁾ Whilst both of them have adopted the four conditions, Article 49 of China-Pakistan FTA uses “domestic legal procedure” and Article 145 of China-New Zealand FTA chooses “applicable domestic law”.

¹⁷³⁾ Article 145 of China-New Zealand FTA.

- by a covered investor, which may either be a failure to act or an omission of act by the host state; in most cases omission alone may not constitute a measure tantamount to expropriation;¹⁷⁴⁾ the investment expropriated may be in the form of intangible or tangible property.¹⁷⁵⁾
- b. The taking must be substantial that has effectively deprived the investor of his economic use and enjoyment of the rights to the property or a distinctive part of such property, provided the taking is permanent in nature which usually involves a transfer of ownership from the investor to another person.¹⁷⁶⁾
 - c. The taking may be *de jure* or *de facto* and “direct” or “indirect”,¹⁷⁷⁾ and may be a single measure or a series of measures that the totality of which has the effect of expropriation (often referred to as creeping expropriation).
 - d. The taking is out of the investor’s reasonable “investment-backed-expectations”.¹⁷⁸⁾

¹⁷⁴⁾ See *Draft Articles on Responsibility of States for International Wrongful Acts*, adopted by the International Law Commission at its 53rd session (2001), Article 2, available at: [http://www.un.org/law/ilc/texts/State responsibility/responsibilityfra.htm](http://www.un.org/law/ilc/texts/State%20responsibility/responsibilityfra.htm).

¹⁷⁵⁾ *Mondev International Ltd. v. United States*, ICSID Case No. ARB(AF)/99/2, Award, 11 October 2002, at 98, available at: <http://ita.law.uvic.ca/documents/Mondev-Final.pdf> and also *Methanex Corp. v. United States of America*, Final Award, 3 August 2005, at p. 17, available at: <http://ita.law.uvic.ca/documents/MethanexFinalAward.pdf>.

¹⁷⁶⁾ According to the tribunal of *Tippets case*, “A deprivation or taking of property may occur under international law through interference by a state in the use of that property or the enjoyment of its benefits, even where legal title to that property is not affected”. See *Tippets, Abbett, McCarthy, Stratton v. TAMS-AFFA Consulting Engineers of Iran*, Award No. 141-7-2, reprinted in 6 *Iran-United States Cl. Trib.* 219 (1984).

¹⁷⁷⁾ Whether a given measure is *de jure* or *de facto* is insignificant in judging its constitution of expropriation or taking of property. Indirect expropriation has also become a common phenomenon of BITs. This is illustrated by Article 1110(1) of the NAFTA that “No Party may directly or indirectly nationalize or expropriate ... or take a measure tantamount to nationalization or expropriation ...”. In practice an indirect expropriation is interpreted as a measure that equivalent to expropriation or having the effect of expropriation. See *Pope & Talbot Inc. v. The Government of Canada*, Interim Award, 26 June 2000, at pp. 96 and 104, available at: <http://ita.law.uvic.ca/documents/Pope-InterimAward.pdf>; also *SD. Myers Inc. v. The Government of Canada*, Partial Award, 13 November 2000, at pp. 285-286, available at: <http://ita.law.uvic.ca/documents/SDMevers-1stPartialAward.pdf>; *Marvin Roy Feldman Kappa v. United Mexican States*, ICSID Case No. ARB(AF)/99/1, Award, 16 December 2002, at p. 100, available at: http://ita.law.uvic.ca/documents/feldman_mexico-award-english.pdf.

In practice, expropriation may be compensable or non-compensable depending on the circumstance. It is observed that a regulatory action by public authorities of the host state is unlikely to be the subject of legitimate complaint under Article 1110 of the NAFTA.¹⁷⁹⁾ When considering whether a regulatory action may be subject to legitimate complaint, other relevant factors must also be taken into account, such as the scope of the police powers, the purpose and effect of the measure, the proportionality of the measure between the means employed and the aim sought to be realized,¹⁸⁰⁾ the *bona fide* nature of the measure,¹⁸¹⁾ e.g., whether it involves discrimination.¹⁸²⁾

Fair market value as the standard for compensation is now totally acceptable to China, although the wording may differ from BIT to BIT and from FTA to FTA.¹⁸³⁾ In this respect, the China-New Zealand FTA contains detailed provisions on calculation

¹⁷⁸⁾ The relevance of investor's expectation to expropriation is that in some businesses, government intervention is expected, in which circumstance foreign investor concerned may not bring a legitimate complaint for expropriation as a result of intervention/regulation by the host government.

¹⁷⁹⁾ See *SD. Myers Inc. v. The Government of Canada*, Partial Award, 13 November 2000, at p. 281, available at: <http://ita.law.uvic.ca/documents/SDMyers-1stPartialAward.pdf>.

¹⁸⁰⁾ See *Tecnicas Medioambientales Teemed SA. v. United Mexican States*, ICSID Case No. ARB(AF)/00/2, Award, 29 May 2003, at, p. 122 *et seq.*, available at: http://ita.law.uvic.ca/documents/Tecnicas_001.pdf.

¹⁸¹⁾ For discussions on the issue see Jack Coe, Jr., and Noah Rubins, "Regulatory Expropriation and the Teemed Case: Context and Contributions", in Todd Weiler, Ed., *International Investment Law and Arbitration: Leading Cases from the ICSID, NAFTA, Bilateral Treaties and Customary International Law* (2005) 597 at 632-643, and L. Yves Fortier and Stephen L. Drymer, "Indirect Expropriation in the Law of International Investment: I Know It When I See It, or Caveat Investor", Vol. 19, No.2, *ICSID Rev.-FILJ* (2004) 293-327.

¹⁸²⁾ Discrimination is always an important factor in disputes involving expropriation. In *Fireman's Fund Insurance* case, the tribunal observed "If there is a "haircut" for holders of debentures, all should be shaven. Conversely, if one is allowed to escape the hands of the barber, the other should be allowed to escape as well." See *Fireman's Fund Insurance Company v. The United Mexican States*, ICSID (Additional Facility), Para. 203.

¹⁸³⁾ For instance, China-Pakistan FTA (Article 49) requires compensation to be equivalent to the value of the expropriated investments immediately before the expropriation or the impending expropriation becomes public knowledge, whichever is earlier.

of compensation by stating, for instance, that where “the fair market value is denominated in a freely usable currency”,¹⁸⁴⁾ the compensation must be ascertained in accordance with the “fair market value on the date of expropriation, plus interest at a commercially reasonable rate for that currency, accrued from the date of expropriation until the date of payment”.¹⁸⁵⁾ In case the fair market value is denominated in a non-freely usable currency, the compensation should be calculated at the prevailing market exchange rate for a freely usable currency on the date of payment.¹⁸⁶⁾

V. Investor-State Dispute Settlement

Disputes settlement mechanism in China's earlier BITs usually excluded the jurisdiction of ICSID. Even for those BITs where ICSID jurisdiction was permitted, disputes that could be subject to international arbitration were limited to the scope of expropriation and compensation,¹⁸⁷⁾ which practice has changed

¹⁸⁴⁾ According to the International Monetary Fund, US dollars, Japanese yen, pond sterling and Euro are usable currencies. See Selected Decisions and Selected Documents of the IMF, Thirtieth Issue – Freely Usable Currencies, as updated as of June 30, 2006.

¹⁸⁵⁾ Article 145(3) of China-New Zealand FTA.

¹⁸⁶⁾ The same applies to interest payment but not apply to circumstances of compulsory license under the TRIPs of the WTO. See Article 145(4) and (5) of China-New Zealand FTA.

¹⁸⁷⁾ For example, Article 9(3) of the 1994 China-Iceland BIT states “If a dispute involving the amount of compensation for expropriation cannot be settled within six months after resort to negotiations as specified in paragraph 1 of this Article, it may be submitted at the request of either party to the International Centre for Settlement of Investment Disputes (ICSID) or to an *ad hoc* arbitral tribunal. Any dispute concerning other matters between an investor of either Contracting Party and the other Contracting Party may be submitted by mutual agreement to an *ad hoc* arbitral tribunal. The provisions of this paragraph shall not apply if the investor concerned has resorted to the procedure specified in paragraph 2 of this Article.” Article XII(2) of the 1988 China-Australia BIT provides: “If the dispute has not been settled within three months from the date either party gave notice in writing to the other concerning the dispute, either party may take the following action: (a) in accordance with the law

dramatically in recent years. In 1998, China entered into a BIT with Barbados whereby disputes between a foreign investor and the host state are permitted first to be settled through friendly negotiation, and if no solution can be reached within a reasonable period of time, upon the investor's discretion, they then may be submitted to the ICSID for arbitration.¹⁸⁸⁾ Similar provisions can be found in most recent BITs that China is a party. These BITs do not exclude the jurisdiction of ICSID in relation to important issues such as denial of benefits to the foreign investors with capital from the host country or controlled or owned by domestic entities of the host country, prudent financial supervisory measures adopted by the host country, and significant safety exceptions, etc.¹⁸⁹⁾ Such changes in Chinese bilateral investment treaty practice have a lot to do with the fact that in recent years more and more Chinese entities began to invest overseas.¹⁹⁰⁾ China is no

of the Contracting Party which has admitted the investment, initiate proceedings before its competent judicial or administrative bodies; and (b) where the parties agree or where the dispute relates to the amount of compensation payable under Article VIII, submit the dispute to an Arbitral Tribunal constituted in accordance with Annex A of this Agreement.

¹⁸⁸⁾ Article 8 of the Agreement between the Government of the People's Republic of China and the Government of Barbados on the Encouragement and Reciprocal Protection of Investments. This Agreement was signed on July 20, 1998 and entered into force on October 1, 1999, <http://www.asianlii.org/cn/legis/cen/laws/abtgotprocatgobctearpoi1447/>.

¹⁸⁹⁾ For example, Article 9 of the 2003 China-Germany BIT provides that "(1) Any dispute concerning investments between a Contracting Party and an investor of the other Contracting Party should as far as possible be settled amicably between the parties in dispute. (2) If the dispute cannot be settled within six months of the date when it has been raised by one of the parties in dispute, it shall, at the request of the investor of the other Contracting State, be submitted for arbitration. (3) The dispute shall be submitted for arbitration under the Convention of 18 March 1965 on the Settlement of Investment Disputes between States and Nationals of other State (ICSID), unless the parties in dispute agree on an *ad hoc* arbitral tribunal to be established under the Arbitration Rules of the United Nations Commission on the International Trade Law (UNCITRAL) or other arbitration rule." It should be noted that the 2004 US Model BIT excludes such items from ICSID's jurisdiction.

¹⁹⁰⁾ China's FDI outflows increased by 32% to \$16 billion in 2006, and its outward FDI stock reached \$73 billion, being the 6th largest in the developing world. Part of this overseas expansion involves considerable investment in other developing and transition economies. See UNCTAD, *2007 World Investment Report*, p. 44.

longer only the largest developing host country of foreign investments but also an important capital exporting state. For the purpose of protecting its own natural and legal persons investing overseas, it is necessary for China to accept the investor-state arbitration as a norm of international investment law.

China-Pakistan FTA and China-New Zealand FTA also provide for investor-state arbitration. Both FTAs make amicable settlement through negotiation as prerequisite for submission of a dispute to international arbitration, the period of which is six months.¹⁹¹⁾ Thereafter, the investor concerned may decide to submit its dispute through other means. Under China-Pakistan FTA, the alternate means include submit the dispute to a competent domestic court of the host country and arbitration at ICSID; once a local court is chosen, it will exclude the possibility of submitting the same dispute to ICSID for arbitration.¹⁹²⁾ China-New Zealand also authorizes investors to submit disputes to ICSID for arbitration. At the same time, investors may make use of ICSID conciliation or UNCITRAL arbitration procedures.¹⁹³⁾ Before availing themselves of international arbitration, the three month advanced notice condition must be satisfied. The purpose of this provision is to afford the host country an opportunity to require the investor concerned to go through administrative review procedures which must already exist in the laws and regulations of the host country.¹⁹⁴⁾ The administrative review process in any event may not exceed three months.

Host countries always welcome investors to submit their disputes to local courts, whilst investors in most cases prefer international arbitration. Under China-New Zealand FTA, an investor, having submitted its dispute to a local court of the host country, may later decide to resort to international arbitration provided that it has withdrawn its case from the domestic court before a final judgment is reached.¹⁹⁵⁾

¹⁹¹⁾ See Article 152 and 153 of China-New Zealand FTA and Article 55(1) and (2) of China-Pakistan FTA.

¹⁹²⁾ Article 55(2) of China-Pakistan FTA.

¹⁹³⁾ Article 153(2) of China-New Zealand FTA.

¹⁹⁴⁾ Article 153(2) of China-New Zealand FTA.

¹⁹⁵⁾ Article 153(3) of China-New Zealand FTA.

This arrangement is in contrast with that under China-Pakistan FTA.

China-New Zealand FTA also has detailed rules on arbitration procedures which have the effect of modifying the domestic laws of the Parties and those of ICSID.¹⁹⁶⁾ One of such modification is that the limitation period for submission of disputes must be within three years from “the time at which the disputing investor became aware, or should reasonably have become aware, of a breach of obligation” by the host country, which has caused loss or damage to the investor or its investments.¹⁹⁷⁾

Challenge of jurisdiction of arbitral tribunal and objection to arbitration on basis that the claim is without merit have become common tactic in international arbitration. According to the ICSID Convention, a pre-condition for ICSID’s jurisdiction is that the dispute in question must be legal in nature. “The jurisdiction of the Centre shall extend to any legal dispute arising directly out of an investment, between a Contracting State ... and a national of another Contracting State”.¹⁹⁸⁾ In practice what may constitute a legal dispute has been given a wide interpretation. In *Saipem*, Bangladesh argued that the existence of a legal dispute within the meaning of the above provision presupposed the “existence of a cause of action” and that as its dispute with the claimant was on an arbitral award issued by International Chamber of Commerce, it did not constitute a legal dispute.¹⁹⁹⁾ The tribunal however held a dispute over an arbitral award to have satisfied the requirement as “it involves a disagreement about legal rights or obligations.”²⁰⁰⁾

¹⁹⁶⁾ Article 153(4) of China-New Zealand FTA clearly states that the provisions of the FTA on dispute settlement prevails over both ICSID and UNCITRAL arbitration and conciliation procedures.

¹⁹⁷⁾ Article 154(1) of China-New Zealand FTA.

¹⁹⁸⁾ Article 25(1) of the ICSID Convention.

¹⁹⁹⁾ The BIT between Bangladesh and Italy defines “investment” as “any kind of property invested” including “credit for sums of money or any right for pledges or services having an economic value connected with investments” (Art 1(1)).

²⁰⁰⁾ *Saipem S.p.A. v. The People’s Republic of Bangladesh*, ICSID Case No. ARB/05/07, issued on March 21, 2007, Para. 94. Obviously, the tribunal of *Saipem* was influenced by the Report of the Executive Directors of the World Bank on the Convention, that where there exists a dispute involving the determination of the existence of legal rights or the scope thereof of a party, it is a legal dispute. See “Report of the Executive Directors on the Convention on the Settlement of Investment Disputes Between States

The underlining principle is that the “rights embodied in the ICC Award were not created by the Award, but arise out of the Contract. The ICC Award crystallized the parties’ rights and obligations under the original contract. It can thus be left open whether the Award itself qualifies as an investment, since the contract rights which are crystallized by the Award constitute an investment within Article 1 (1)(c) of the BIT”.²⁰¹⁾ Then what is the response of China to this issue?

The China-New Zealand FTA requires that a state party which wishes to raise objections to jurisdiction must file its submission no later than 30 days after the constitution of the tribunal.²⁰²⁾ The tribunal must decide on the issue of objection first and must give the parties a reasonable opportunity to present their views and observations.²⁰³⁾ With regard to interpretation of the FTA, the state party to a dispute may request the tribunal to seek joint interpretation by the Parties thereto. The joint interpretation which must be reached within 60 days has binding force on the tribunal. Where a joint interpretation is not reached, the tribunal should decide the issue on its own account.²⁰⁴⁾ This looks like a balanced arrangement: on the one hand it requires the state party to disputes to take actions without delay and on the other hand the FTA Contracting Parties may give joint interpretations. It is always the Chinese position that those who have participated in the law-making should know best the meaning of the provisions thereof.

With government accountability in respect of arbitration growing, China-New Zealand FTA permits a state disputing party to make public all documents relating

and Nationals of Other States”, World Bank, 18 March 1965, para. 26; available at <http://www.worldbank.org/icsid/basicdoc/partB-section05.htm#03>.

²⁰¹⁾ Saipem S.p.A. v. The People’s Republic of Bangladesh, ICSID Case No. ARB/05/07, Para. 127. In the view of the tribunal, “the notion of investment pursuant to Article 25 of the ICSID must be understood as covering all the elements of the operation, that is not only the ICC Arbitration, but also inter alia the Contract, the construction itself and the Retention Money.” *Id.*, Para. 114.

²⁰²⁾ Article 154(2) of China-New Zealand FTA.

²⁰³⁾ Article 154(3) of China-New Zealand FTA. When making a decision, the tribunal must consider whether either the claim or the objection was frivolous or manifestly without merit.

²⁰⁴⁾ Article 155 of China-New Zealand FTA.

to arbitration, except those specifically designated as confidential information when submitted to the arbitral tribunal.²⁰⁵⁾

Award of the tribunal is final and may be in the form of (a) monetary damages plus interest or (b) restitution of property, in which case the state party may choose to pay monetary damages in lieu of restitution.²⁰⁶⁾ Although costs and fees may be included in an award, no punitive damages may be awarded.²⁰⁷⁾ Also a “disputing party may not seek enforcement of a final award until all applicable review procedures have been completed”.²⁰⁸⁾

As discussed earlier, to accept jurisdiction of ICSID without reservation has become a standard practice of China. An important issue is whether foreign investors whose country’s BITs exclude ICSID jurisdiction or accepts the jurisdiction thereof but with reservations may bring their disputes with China to ICSID through operation of the MFN clause.²⁰⁹⁾ Currently in all the BITs that China has entered into, there is a MFN clause ensuring “no less favorable” treatment than that to any third-party investors. Where an investor may, by invoking the MFN clause of a third-state agreement, be entitled to the right of bringing its dispute with the host country for arbitration at ICSID, there will be tremendous uncertainty.

China appears to have adopted a position on the abovementioned issue relating to operation of the MFN clause. The China-New Zealand Free Trade Agreement is

²⁰⁵⁾ Article 157 of China-New Zealand FTA.

²⁰⁶⁾ Article 158(1) of China-New Zealand FTA.

²⁰⁷⁾ Article 158(3) of China-New Zealand FTA.

²⁰⁸⁾ Article 158(5) of China-New Zealand FTA.

²⁰⁹⁾ At the moment, international practice throws little light on the solution of the issue. Some countries have, apparently for the purpose of certainty, inserted explicit rules in their BITs on the application of the MFN clause to dispute settlement. For instance, the UK-Albania BIT entered into in 1994 provides that “for the avoidance of doubt it is confirmed that the treatment provided for in paragraphs (1) and (2) above (national and MFN treatment) shall apply to the provisions of Articles 1 to 11 of this Agreement (Article 8 is on dispute settlement)”. Similar provisions could also be found in the Annex to the 2004 Canada Model BIT, which stipulates that “Article 4 shall not apply to treatment accorded under all bilateral or multilateral international agreements in force or signed prior to the date of entry into force of this Agreement.”

an example. Following a general stipulation on granting MFN treatment to “investors, investments and activities associated with such investments by investors of the other Party ... in like circumstances ... with respect to admission, expansion, management, conduct, operation, maintenance, use, enjoyment and disposal”,²¹⁰⁾ Article 139 continues to provide:

For greater certainty, the obligation in this Article does not encompass a requirement to extend to investors of the other Party dispute resolution procedures other than those set out in this Chapter.²¹¹⁾

In conclusion, over the last thirty years and more, China has emerged as an important player, both in terms of capital recipient and exporter, in international investment. Its legal system and treaty practices thereof are in the main trend of the international community.

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²¹⁰⁾ Article 139(1) of China-New Zealand FTA.

²¹¹⁾ *Ibid.*, Article 139(2).

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